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Editor's Letter

Welcome to the Redesigned Bloomberg Businessweek

In the five months since Bloomberg LP acquired *Businessweek* and I became the magazine's editor, not one of our 900,000 subscribers and 4.7 million readers has written to demand a thorough redesign. I've seen letters about our coverage of President Obama and Goldman Sachs (not surprisingly, they're split down the middle) and letters about the pronunciation of my last name. (Josh is really fine.) Yet no one has felt the need to critique our fonts.

So why, you may be asking, does the magazine suddenly look so different?

Part of the reason is the conjunction of the words Bloomberg and *Businessweek*. Bringing the two news organizations together gives us unprecedented breadth and depth. There are now 1,700 journalists in 72 countries committed to giving you exclusive news, analysis, and data.

Harnessing that power led us to ask important questions about the organization of the magazine—and to ask our readers how we could best serve your needs. We listened closely, and then we got to work.

Our mission remains the same—to cover the world of business and prepare you to compete in the week ahead. There's more news, more angles, more locations, and more competition. To make this magazine an indispensable part of your life, we've expanded each issue by adding 20% more editorial pages and redesigned them to accommodate roughly twice the number of stories. In most businesses, that's called value for money.

We also think you'll like the way we've structured the magazine so you can instantly find the information you want. Each issue begins with Opening Remarks, a richly reported essay on one of the week's most important stories. Some weeks, like this one, Opening Remarks may well be our cover.

The opener is followed by five weekly sections—Global Economics, Companies & Industries, Politics & Policy, Technology, and Markets & Finance. This week, and in many weeks to come, we'll add a sixth section that focuses on a particular slice of business, from enterprise to clean energy. At the center of the magazine are features full of in-depth storytelling and photography that introduce you to the people, places, and ideas shaping our world. Finally, we've added a new section, Etc., about the workplace—and life away from it.

The new look of *Bloomberg Businessweek* reflects Creative Director Richard Turley's primary goal—to make the magazine easy to navigate, with small color cues for each section and bold, clean headlines. "Design is best when you don't know it's there," says Richard. "We want the journalism to speak loudest."

We'll continue to make adjustments over the coming weeks. We ask that you guide us with feedback. E-mail your likes, dislikes, and suggestions to comments@businessweek.com. As for letters demanding a redesign, I hope they continue to be scarce.

Josh Tyrangiel, Editor

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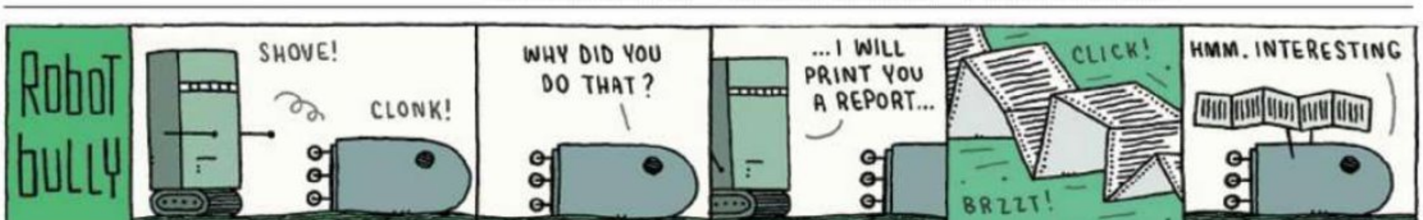
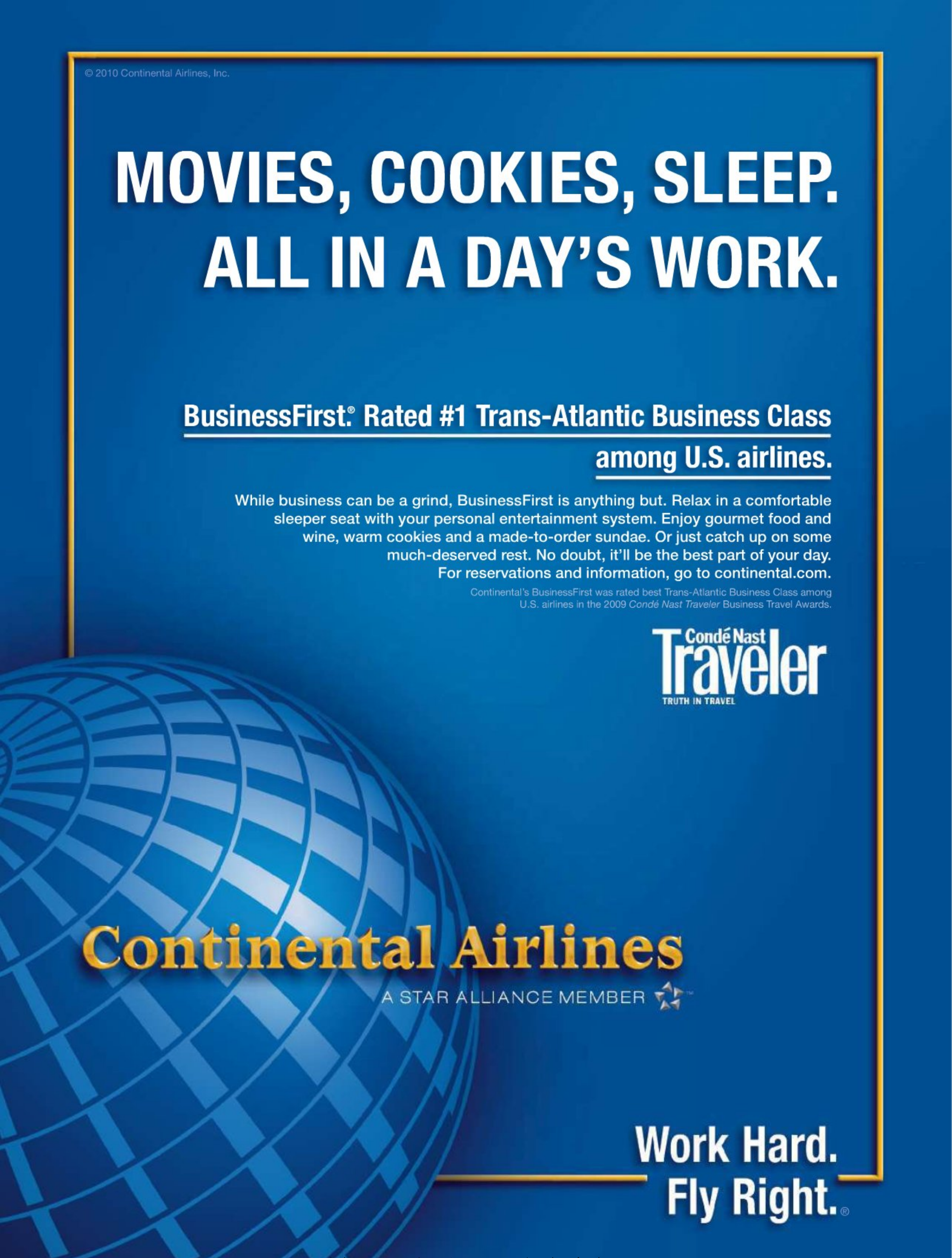


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Opening Remarks



Goldman's Blankfein, preparing to testify in Washington early this year, finds himself on the hot seat again

Goldman Slapped

A civil suit and a Senate scolding won't be enough to make Wall Street's wealthiest firm fly right

By Jonathan Weil

The satraps of Capitol Hill don't have much taste for aggressive financial reform. They do have a certain talent, however, for the theater of aggressive reform. And when Goldman Sachs CEO Lloyd Blankfein settles in at the witness table of the Senate Permanent Subcommittee on Investigations on Tuesday, that's what they'll try to deliver: a moment that crystallizes three years of global disgust with the smart money boys who seem to have played the rest of us for fools.

When the curtain falls, the case that brought Blankfein to the hot seat—the Securities & Exchange Commission's civil lawsuit alleging that Goldman misled investors when it sold them subprime-mortgage-related investments that were designed to blow up—will still be one small, rotten potato in a large and smelly field. The reforms that might prevent this sort of chicanery will still be elusive. And Goldman, which calls the allegations "completely unfounded" and vows to defend itself "vigorously," will still be the most spectacular cash machine that banking has ever seen.

The SEC chose this case because it is comparatively stark. In early 2007, at the request of Paulson & Co., the hedge fund run by billionaire John Paulson, Goldman structured a deal called Abacus 2007-AC1, designed to let Paulson wager that the subprime-mortgage industry would collapse. Goldman lined up two counterparties for a fee of $15 million: ACA, a bond-insurance company, lost about $950 million (with the banks backstopping it), and a German bank called IKB lost $150 million. Goldman's offense, according to the SEC, was telling IKB that the portfolio of mortgage bonds used for the deal was "selected by ACA," when in fact Paulson was deeply involved in the process, cherry-picking the worst bonds it could find. Goldman didn't tell IKB who was on the other side of the trade, or the extent to which Paulson influenced selections. As a result, the SEC claims, Goldman's statement to IKB was false, misleading, and fraudulent.

The Abacus case is of course far more complex and nuanced than the SEC complaint lets on. This is a cast of characters without a single hero. Not even the supposed victims are sympathetic. IKB sold commercial-paper IOUs to investors in mid-2007 that were worthless by year's end. Its former CEO, Stefan Ortseifen, went on trial last month in Germany for allegedly lying about IKB's financial condition before its near-collapse.

The credit-rating merchants, whose incompetence cannot be overstated, make their usual cameo, as well. And while Paulson didn't get sued, because the SEC said he made no misrepresentations, he did make $1 billion on the deal. Having his name associated with this alleged fleecing carries its own unknowable reputational risk.

JAY WESTCOTT/POLARIS

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Opening Remarks

The SEC, trying to show that it has grown teeth after doing nothing while Bernie Madoff looted and Lehman Brothers fell to dust, doesn't appear pristine either. Its enforcement chief, Robert Khuzami, until last year was a top lawyer at Deutsche Bank, which, like Goldman, structured transactions for hedge funds betting against subprime bonds. While Khuzami has said he would recuse himself from matters involving Deutsche Bank, he's free to probe its competitors. The SEC filed the suit the same day its inspector general released a horrific report on the agency's decade-long failure to catch accused Ponzi artist Allen Stanford. That PR trick relegated what would have been the day's biggest financial story to the inside pages. The IG's report said the enforcement chief in the Fort Worth office quashed his staff's efforts to investigate, then left for private practice–and landed Stanford as a client. The effrontery of that may well supersede anything Goldman and Paulson are alleged to have done.

The only players in this game that can't speak up for themselves are the synthetic collateralized debt obligations. Their value was tied to the performance of credit-default swaps, derivatives that can be used to protect a bondholder from losses. They're not evil. The problem is they're barely regulated. What's needed are rules to make sure they're used transparently by investors with the capital to absorb losses.

What distinguishes the Abacus case from other doomed subprime deals are the e-mails written by a young Goldman vice-president and now co-defendant, Fabrice Tourre (page 58). Had he not typed quite so effusively–"Only potential survivor, the fabulous Fab ... standing in the middle of all these complex, highly leveraged, exotic trades"–the SEC might not have had a case and Blankfein might have avoided the hot seat. In one internal Goldman e-mail sent in March 2007, Tourre, now 31, describes the portfolio as "selected by ACA/Paulson." In others, he frets that the housing market might crash before Goldman could close the transaction. Tourre's e-mails may buttress Goldman's basic strategy, which is to cast the SEC's suit as an argument over the conduct of a single employee. "It's all going to be a factual dispute about what he remembers and what the other folks remember on the other side," Greg Palm, Goldman Sachs's co-general counsel, said in a call with reporters on Apr. 20. "If we had evidence that someone here was trying to mislead someone ... we'd be the first one to take action."

In Washington, Blankfein will find a panel of lawmakers happily getting in touch with their prosecutorial roots



Investigations Chairman Levin has been digging into both financial manipulation and human motivation

When Tourre tells his story–which he is expected to do before the same Senate panel that grills Blankfein–he can either support or explode this argument. "If Tourre says, 'Goldman's board knew what we were doing,' you can imagine Goldman will want to portray him as disgruntled," says Onnig Dombalagian, a professor at Tulane University Law School and a former SEC attorney. That may not help the firm itself, he added. "Under theories of vicarious liability, if you can find Tourre liable, it's going to be hard for Goldman to escape."

When Blankfein arrives in Washington, he will find a panel of lawmakers happily getting in touch with their prosecutorial roots. Investigations subcommittee Chairman Carl Levin (D-Mich.) has been using his subprime probe to dig into the complexities of both financial manipulation and human motivation. If Blankfein argues that the buck stopped with Fab, Levin will skewer him. He is not beholden to Goldman. Of the 10 committee members, four have accepted substantial contributions from the firm: Mark Pryor, Jon Tester, Susan Collins, and John McCain. Levin has subpoena power, and SEC and Justice Dept. personnel detailed to his committee. In addition to Blankfein and Tourre, he is expected to call Goldman executives Craig Broderick, the chief risk officer, and David Viniar, the CFO. One key theme will be inconsistencies between the public record and what Goldman people were saying in private.

One defense Blankfein may emphasize this week could surprise people: Goldman says it got sheared on the Abacus deal. Palm, the co-general counsel, said the firm lost more than $100 million, but the red ink looks awfully convenient. Goldman won't reveal the positions in its mortgage trading book, so there's no way to tell what's real.

If Goldman seems vulnerable to attack, so does an element of the SEC's case–the notion that Tourre misled ACA into thinking Paulson had planned to place a bullish bet when the two were negotiating which mortgages bonds to pick for the CDO.

The Abacus transaction closed on Apr. 26, 2007. By then it was a matter of public record that Paulson had begun profiting on credit derivatives that increased in value as subprime bonds fell. On Mar. 15, Bloomberg News reported that one of Paulson's startup credit funds had gained 67% in eight months. In a letter to his funds' investors quoted by Bloomberg, Paulson wrote: "We believe we are in the early stage of a correction in this market and that the market will eventually implode." The article also quoted him as saying that bad loans made to the riskiest borrowers would "skyrocket" and that "most, if not all, of the independent originators will go bankrupt."

Even the most basic due diligence should have made Paulson's trading strategy clear. That article and others like it can be found with a Google search. ACA and Paulson spent weeks negotiating which bonds would be selected. If each knew the other's intentions, that knocks a hole in the idea that ACA got hustled.

That's a legal matter. What concerns Goldman this week is politics and public relations. It knows how to make money and how to defend those methods in court. What it hasn't been very good at is getting the world to see it the way it sees itself. When Blankfein settles into his chair in Washington, he's hoping what he says will mark the beginning of a long, slow process of turning that perception around.

The timing may not be all bad. Before the SEC's case hit, a certain exuberance had returned to the markets. Big bonuses were back, as was the hot pursuit of risky assets. The spectacle of Blankfein being called upon to explain the actions of an impetuous young man and his bosses should be the spur Wall Street needs to start its own genuine reform process. If ever there were a time to relearn commonsensical standards of behavior and weed out the Fabs before the government comes calling, this is it. Ⓑ

—With Lorraine Woellert

PABLO MARTINEZ MONSIVAIS/AP

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A Message to Wall Street's Fabulous Fabs

Goldman will survive, but the expectations have changed

By Michael Lewis

If you happen to be sitting on the Goldman Sachs bond-trading floor, life must feel horribly unfair. You did nothing worse than live by the ethical assumptions of your market—any money-making event short of obviously illegal is admirable—and now your own grandfather thinks you're some kind of monster. Your world feels upside down. What was right is now wrong, what was good is now bad, what once felt like winning now feels like losing. You're probably wondering: What next? What will the angry rabble—all those ordinary people who can never really understand your business—now demand that you explain to them, so they can disapprove of you all over again?

Here, for a start, is what the world beyond Wall Street is entitled to:

Full knowledge of the inner workings of your proprietary trading desk. In particular, the moment-to-moment dealings of your correlations traders from late 2004, when they first exploited AIG's idiotic willingness to sell cheap insurance on pools of subprime mortgage loans, until the end of 2007, when they would have taken most of their profits from the total collapse of the subprime bond markets.

Your bosses claim to have lost $100 million or more on the Abacus trade for which your firm is being sued. This seems, to put it mildly, disingenuous. In March 2007, the time of this particular Abacus trade, your prop traders were already short the subprime market. Would they really have taken a naked long position in a deal you helped to construct precisely so that it would fail, without offsetting in some other way on their books?

Sadly, it will not suffice to offer up Fabrice Tourre as a ritual sacrifice. No one is going to accept a then-27-year-old Frenchman, whose job was apparently to keep sweet the patsies on the other end of your trades, as the world's authority on your trading positions. His name isn't even on the top of the list of Goldman traders on the $2 billion Abacus deal for which you are being sued. The name on top of that document is "Jonathan Egol." Egol appears to have been the bond trader at the center of your Abacus program. The same Jonathan Egol who told fellow traders in 2006—a year before this transaction—that the subprime market was doomed. The public eventually will ask: Who is Jonathan Egol, and what exactly was his game?

Then there's the matter of your relations with the inaptly named "CDO manager." In this case, the manager was ACA but it wasn't the only one. Others were equally pliable. The Securities & Exchange Commission lawsuit charges you with using ACA as a shill: The investors in these deals assumed that it was ACA's job to figure out whether the bonds inside the collateralized debt obligations were intelligent investments. But ACA quite clearly had no idea what it was doing—and you quite clearly understood that.

The telling details here are the e-mails between your French salesman and ACA in which ACA feels it needs to understand exactly what John Paulson's interests are in this new CDO. Paulson, who had done a great deal of analysis on the underlying bonds, was of course picking the ones he wanted to see inside the CDO. (Hard to understand why it didn't disturb you that he was even in the conversation, by the way, but that's another story.) The SEC accuses you of lying to ACA by suggesting that Paulson was a long investor in the deal when he was in fact selling the deal short.

> Nobody is going to accept that a 27-year-old was the authority on Goldman's trading positions

What's interesting here is what you appear to take for granted: that ACA has no talent for evaluating the bonds picked by Paulson. After all, if ACA was doing its job it wouldn't have cared one way or the other what Paulson (then a third-tier hedge fund manager) was up to. ACA would have known which bonds were good and which were bad, and picked the good ones. In their anxiety about Paulson's motives we can all glimpse their incompetence. They want to know that Paulson has an interest in picking the good ones because they themselves have no clue which ones they are.

But if a CDO manager had no independent ability to select the bonds inside a CDO, then what, please explain to us, was its financial function? Why did you select ACA to manage your deal?

Finally, what is the reason for being so unconcerned for so long with the consequences of your actions? The masses deserve to know, for instance, how you became blinded to the very simple difference between right and wrong. The more moralistic among them will ask the question mainly to fuel their own outrage, the more tactical will ask the question because they sense that the financial system doesn't function unless you have the incentive to think in these terms—and you clearly do not. What begins as an effort to change your business may well end up as an attempt to change your soul.

Just as there was a time when people could smoke on airplanes, or drive drunk without guilt, there was a time when a Wall Street bond trader could work with a short seller to create a bond to fail, trick and bribe the ratings agencies into blessing the bond, then sell the bond to a slow-witted German without having to worry if anyone would ever know, or care, what he'd just done. That just changed. Ⓑ

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Global Economics



Chrysler dealership in Baghdad: Pent-up demand from consumers is powering Iraq's economic growth

Iraq's Economy Wakes Up

▶ **Investment and products from abroad begin flowing—along with oil**

▶ **Boosting private investment won't be easy. Officials were "raised in a statist environment"**

PHOTOGRAPH BY AYMAN OGHANNA FOR BLOOMBERG BUSINESSWEEK

Customers heading for a Baghdad branch of **Dar Es Salaam Investment Bank** know the drill. You walk through the entrance and heavily armed guards stop you. You get body-searched at least twice. And your phone is taken away before you reach a teller. Mobile phones, of course, can trigger bombs or send a signal to armed accomplices.

Yet Dar Es Salaam (known as DES) is thriving as Iraq begins to show signs of life. Profits have grown from about $600,000 in 2004 to more than $16 million. **HSBC**, the giant international bank that bought 70% of DES in 2005, feels so confident that it may put its own brand on the banks. "We think the timing is right," says James Hogan, HSBC's country manager. "Iraqis are starting to reconnect to the outside world."

Seven years after the ouster of Saddam Hussein, Iraq has changed. Yes, convoys of SUVs packed with heavily armed security men still roar down Baghdad's busy streets. Armed gangs still prey on truckers. Iraq's political class struggles to form a new government. The few expat managers in the country live like prisoners: Every night, HSBC's Hogan holes up in a walled compound run by a security company.

Ordinary Iraqis, however, are living more normally than they have in years. Shops on Saadoun and Karrada Streets are filled with flat-screen TVs, computers, and clothing from China, Turkey, Iran, and Korea. Pedestrians have to step around the Turkish and Iranian refrigerators and stoves piled outside. At night many Baghdadis relax watching one of the privately owned television channels that have sprung up,

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Global Economics

or checking the latest Iraqi Web sites.

Oil money from rising production is powering growth, as is pent-up demand for housing and better infrastructure. Now that the government has awarded oil-field contracts worth billions of dollars to **BP**, **ExxonMobil**, **China National Petroleum**, and others, foreign clients are besieging Hogan for help in financing everything from pipelines to power grids to workers' camps. Suppliers are following in the majors' footsteps: **Weatherford** for drilling, **Centrilift** for pumps, **Cameron** for valves. The International Monetary Fund figures the economy could grow 7.3% in 2010. In 2003 the economy barely had a pulse.

The central bank, buttressed by the IMF, has stabilized the dinar at about 1,170 to the dollar (it was once 1,500) and has lowered inflation to single digits from a peak of 80% in 2006. Foreign reserves stand at about $50 billion. "This definitely gives predictability," says Marcel Cobuz, Iraq general manager of **Lafarge**, the French building-materials maker.

Lafarge gained its two Iraqi cement plants, both located near Sulaimaniya in Kurdistan, through its acquisition of Egypt's Orascom Cement in 2007. From this relatively safe base–Lafarge has never experienced a security incident–Cobuz is expanding into the trickier center and south of the country. Lafarge now sells almost half its 5-million-ton annual output in Iraq to construction companies in the Baghdad area. Figuring demand for cement can only grow, Cobuz may next buy derelict state-owned plants, refurbish them, and boost production. Construction, he reckons, will be up 15% this year.

One by-product of the regime's fixation on oil is that it has done little to encourage private investment, says Ali Allawi, a former Finance Minister: "[Officials] were raised in a statist environment. They don't see the connection between private-sector investment and reducing unemployment." Entrepreneurs who lack the funds to modernize their businesses struggle against better-financed rivals. Thabet Al-Beldawi, 80, owns an aluminum plant in Baghdad. He's down to 85 employees from 250 since the fall of Saddam Hussein. "There is a growing demand," he says. "But the market is full of cheap imports." Sami Al-Araji, chairman of the National Investment Commission, says the government is now "trying to emphasize the role of the private investor."

The most encouraging thing about Iraq is that outside investors press on. **Schlumberger**, the oil services company, is quickly moving $100 million into Iraq, in part to build a base camp that will employ 300 workers. Iraq Oil Minister Hussein al-Shahristani, who negotiated with the oil majors last year, thinks the oil fields will eventually generate 100,000 Iraqi jobs. Schlumberger's top brass are primed to hire: They figure the country is a Saudi-size opportunity and that up to 100 drilling rigs will be needed for what could be the biggest oil boom of all. The Iraqi people are ready. *—Stanley Reed and Nayla Razzouk, with Kadhim Ajrash and Zahraa Alkhalisi*

The bottom line *Foreign direct investment is key to Iraq's revival, but the IMF figures less than $1 billion came in last year. That number could multiply fast.*

Risk Management

The Plume and The Planes



- **Earlier successes in dealing with ash made airlines complacent**
- **"That's kind of biting us in the back right now"**

Aviation authorities trying to sort out the Icelandic volcano mess have been operating under a cloud of uncertainty. How much volcanic ash and dust can airplanes safely fly through? Where exactly is the ash, how dense is it, and where will it be in a few hours? Lacking reliable answers to these questions, authorities played it safe and stopped thousands of flights after the eruption of Eyjafjallajökull on Apr. 14, stranding passengers around the world and causing airlines to lose more than $200 million a day.

This ignorance was avoidable. Governments and airlines have long known about the risk to aircraft from volcanic ash. They have partly solved the problem by creating a workable system for monitoring the ash and redirecting aircraft

Financial History

Defaults, Near-Defaults, and Other Financial Disasters



1800-1815
Napoleonic Wars. Austria, France, Russia, the German states all default under the cost of financing armies.

1826
Greece defaults for the first of five times. Its first king, Otto, spends his rule fruitlessly trying to stabilize finances.

1932
Germany, devastated by hyperinflation, war reparations, and the Depression, repudiates debt owed U.S. investors.

1973-1989
Sixteen Latin American countries default on tens of billions of dollars, owed mostly to U.S. banks. Citibank almost goes under.

DATA: *THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY* BY CARMEN M. REINHART AND KENNETH S. ROGOFF; BLOOMBERG BUSINESSWEEK

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Deere miscalculates demand page 29 ▶

around it. But they could do more. They haven't invested the money on research and data collection that would be required to minimize disruptions while still guaranteeing passengers' safety.

To some degree, the international effort to minimize harm to aircraft from volcanic ash has been a victim of its own success at steering planes around plumes. Governments stepped up their monitoring and communication efforts after volcanic ash temporarily shut down engines on jets in 1982 in Indonesia and 1989 in Alaska. There were 10 engine shutdowns from 1980 to 2001, but none since, according to Marianne Guffanti, a vulcanologist at the U.S. Geological Survey in Reston, Va. Says Guffanti: "That's kind of biting us in the back right now because the more successful we are, the more people think there's no problem."

Fred Prata, a British climate scientist who has patented an aircraft-mounted device for detecting volcanic ash, says he has encountered the same complacency. Prata estimates that his infrared camera, installed on the front of a plane, would require just $20,000 worth of hardware, although the airlines would also bear costs for airworthiness certification, cockpit redesign, pilot training, and so on. He says he has gotten attention over the past 20 years from manufacturers and airlines after big eruptions, but each time the air cleared, "interest just waned." Air Transport Association of America spokesman David Castelvetter says it would be "premature" to conclude that airlines underinvested in technology for coping with ash.

Volcanic ash is only one of many environmental risks that get short shrift because they occur so rarely, says Richard Posner, a federal appellate judge in Chicago who wrote a 2004 book called *Catastrophe: Risk and Response*. Says Posner: "Because the number of low-probability, catastrophic events is so large, safety agencies, industry, and so on just kind of tune out. Long-range planning is regarded as a luxury." —*Peter Coy*

The bottom line *It is actually possible to plan for "black swan" events. But companies need foresight and discipline to pull it off.*

Crisis in Greece

Strange Encounter: The IMF and Athens

▶ **Former Fund officers say what they would do if they were put in charge**

▶ **"I'd ask to be transferred to the IMF team in Iceland"**

Greece has inched closer to seeking a $61 billion bailout from the European Union and the International Monetary Fund. Things got more complicated when the EU told Athens to accept IMF conditions for a rescue. *Bloomberg Businessweek* asked three former IMF officers, all prominent economists, what they would do if they were put in charge of managing the crisis for the Fund. Below, the comments of Simon Johnson, Kenneth Rogoff, and Michael Mussa.

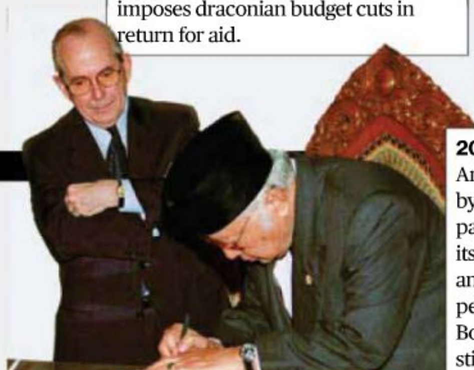
Simon Johnson
MIT
If the IMF offered me the Greece portfolio, I'd ask to be transferred to the IMF team in Iceland. The Fund faces an incredibly difficult job in Greece. The IMF won't have control over Greek monetary policy; that's in the hands of the European Central Bank. The Fund can't steer Greece toward a devaluation; Greece is in the euro zone and can't leave. So it's an emerging-market economy locked inside an exchange rate it can't afford. IMF chief Dominique Strauss-Kahn should impose tough policies on Greece. But DSK also wants to run for President in France. I think there's a conflict of interest here and that he should step down from the Fund.

Kenneth Rogoff
Harvard
What the IMF can do for Greece is buy time by extending bridge loans and lay a framework for paying the debt that gives the market confidence. The Greeks can also blame the IMF when Athens has to get tough. The funny thing is, the IMF has gotten very soft on its conditions since the 2008 crisis started. The G-20 has basically told the IMF to give money now and ask questions later. This could be a problem, since if the Greeks don't close up their deficits, it's game over. The Greeks face an extraordinary tightening. They're like someone who's 75 pounds overweight and must go on a multiyear diet—yet the dieter wants his reward after only losing four pounds. The IMF has to play it straight and give them a normal program, like those



1994
Mexico suddenly devalues the peso, which had been under mounting pressure. The peso's crash triggers a crisis that requires intervention from the U.S. Treasury.

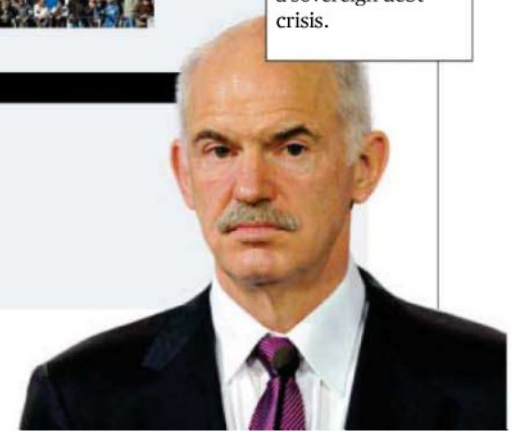
1997-1998
Thailand, Indonesia, and South Korea prove unable to repay dollar-denominated debt as their currencies collapse. IMF boss Michel Camdessus imposes draconian budget cuts in return for aid.





2001-2002
Argentina, beset by budget woes, partly defaults on its foreign debt and abandons the peg to the dollar. Bondholders have still not settled.

2009-2010
Greece, Latvia, Romania, and Hungary all face a sovereign debt crisis.



LEFT TO RIGHT: NAPOLEON; KING OTTO; TREASURY SECRETARY ROBERT RUBIN WITH MEXICAN FINANCE MINISTER GUILLERMO ORTIZ; IMF DIRECTOR CAMDESSUS WITH INDONESIAN PRESIDENT SUHARTO; GREEK PRIME MINISTER GEORGE PAPANDREOU

(VOLCANO, TOP) GUSK/NORDICPHOTOS/GETTY IMAGES (TIMELINE, LEFT TO RIGHT) HULTON/GETTY IMAGES; BETTMANN/CORBIS; BETTMANN/CORBIS; ROBERT NICKELSBERG/TIME & LIFE PICTURES/GETTY IMAGES; TERRY ASHE/TIME LIFE PICTURES/GETTY IMAGES; AGUS LOLONG/AFP/GETTY IMAGES; DANIEL GARCIA/AFP/GETTY IMAGES; GEORGES GOBET/AFP/GETTY IMAGES

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Obituary

C.K. Prahalad



1941—2010

A management thinker who told companies they could boost profits—and benefit the poor—by crafting products for them

C.K. Prahalad, who died Apr. 16 at 68, was hell-bent on shaking managers free of what he called their "dominant logic"—deeply held assumptions about the world. He was a provocative thinker who regularly came up with startling insights that would send executives scrambling. During his 33-year career as a business philosopher, a professor of strategy at the University of Michigan's Stephen M. Ross School of Business, and a well-paid consultant, Prahalad developed theories that have become so commonplace it's easy to underestimate the impact they had at the time. In 1990 he argued that businesses should focus on their "core competence"; corporate strategy has never been the same. Prahalad's insistence that companies engage the billions of potential consumers at the "bottom of the pyramid" was controversial in 2004. Today it's global economic conventional wisdom. His dictum that customers want a greater voice in what they consume has gone from cutting-edge to cliché in six years.

Prahalad was born in the southern Indian state of Tamil Nadu in 1941, one of nine children. He learned his bookish ways from his father, who was a judge and Sanskrit scholar. Prahalad studied at the Indian Institute of Management and then at Harvard, where he received a PhD from the business school. He intended to settle in his homeland but found nationalist India of the 1970s inhospitable to his global outlook. He returned to the U.S., where he could roam intellectually.

Prahalad had eclectic interests: bird migratory habits, historical maps, the spread of languages. He wasn't especially gregarious, but when he traveled, which was often, he tried to pry useful information out of everyone he met. He was always looking for connections and patterns, hoping to predict change.

As a teacher, Prahalad nudged his students to stretch their minds. As a consultant, he demanded his clients do the same. When he arrived for a weekend with senior executives at Royal Philips Electronics in the early 1990s, he told them he had just read a news report that Philips was heading into bankruptcy. "Forget what we are supposed to talk about. There is a major crisis," Prahalad recounted in a 2006 *BusinessWeek* profile. "You had better figure out what you are going to do about it." Within a few hours the executives had drawn up ideas for a radical restructuring. Then Prahalad admitted he had made up the whole thing to spur the team to think creatively. "His style could be mean, but effective," Jan Oosterveld, a retired Philips executive, said at the time.

Among Prahalad's last works was a column in the April *Harvard Business Review*. It concluded with this thought: "Executives are constrained not by resources but by their imagination." Ⓑ
—*Susan Berfield*

Education ▶ **Indian Institute of Management** ▶ **Harvard Business School**
Work ▶ **Management guru** ▶ **Business professor, University of Michigan**
Key Insight ▶ **Billions of consumers await at "the bottom of the pyramid"**

Global Economics

for Brazil or Korea. Not to play it straight would be foolish. The Asians still get angry if they think the IMF is treating a country more leniently than it treated them.

Michael Mussa
Peterson Institute for International Economics
The Greeks face a very big adjustment. The credit markets won't buy their bonds forever, and if you can't finance what you want, you can't have it. On the other hand, an outright sovereign default is a very nasty affair. If you can, you want to avoid that—especially with the European recovery so weak and Portugal and Spain so fragile. The IMF can help here. The Fund has dealt with countries that essentially don't have their own currency. The Argentines had pegged to the dollar, and French Africa to the franc. With the Greeks, the IMF can help fashion a restructuring plan. Then, if fiscal adjustment is not working, the Greeks may be in a better position to default in an orderly way that doesn't roil markets. That's what happened with **GM.** Bush kept it afloat, and later Obama allowed it to go bankrupt when the markets could deal with it. Sometimes kicking the can down the road has its attractions. —*Christopher Power*

The bottom line *The IMF will have to set tough conditions on Athens or risk weakening Europe and alienating Asia.*

Environment

Drought in China Hits The Energy Sector

▶ **Hydroelectric power shortages mount in southwestern China**

▶ **"Another reminder of the very tight water supply" facing the mainland**

It's the worst drought to hit China in a century. In five southwestern provinces, severe rain shortages since October have left 25 million people and 16 million livestock without adequate drinking water and damaged 19 million acres of crops. In Yunnan, the worst-hit province, 8 million Chinese lack sufficient grain, and 5 million have been reduced to taking handouts from the

JAMES LEYNSE/CORBIS

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Global Economics



Ships aground along the Yangtze in Chongqing. Low water levels have caused brownouts in the region

government. Rivers are running dry, and reservoirs stand half-empty.

The drought highlights the risks of China's growing dependence on hydroelectric power. China is the world's biggest producer of hydropower, which supplies some 15% of the country's electricity. Beijing plans to almost double output, to 300 gigawatts of installed capacity, by 2020; the rivers of southwestern China, which feed the giant Mekong system, are an essential part of the planned power grid. Low water levels are already causing brownouts. "This drought has seriously affected hydropower," says Ma Jun, director of the nonprofit Institute of Public & Environmental Affairs in Beijing. "Some rationing of power to factories has been adopted."

If the drought is prolonged, China may have to increase its reliance on coal, which still supplies about 80% of its electricity–and produces much of its air pollution. "The southwest drought will drive demand for coal [and] increase prices," predicts Laby Wu, chief financial officer of Shanxi-based **Puda Coal.** Shares in U.S.-listed Puda have risen by almost 40% this year.

China's pell-mell development has worsened the situation, since widespread deforestation has depleted the southwest's groundwater. Says Ma: "This is another reminder of the very tight water supply facing all of China."
—Dexter Roberts

The bottom line *China's effort to expand hydroelectric power may be threatened by water shortages, and use of polluting coal will likely rise.*

Quoted

"The private banks failed, the supervisory system failed, the politics failed, the administration failed ... and the ideology of an unregulated free market utterly failed."
— Iceland Prime Minister Johanna Sigurdardottir about the Apr. 12 report on Iceland's banking crisis



Demographics

A Fingerprint File For 1.1 Billion Indians

- A software tycoon tackles the job of creating IDs for all citizens
- "This gives them a leg up, a set of tools to meet their aspirations"

One of India's major problems is a lack of information about Indians. The government isn't sure how many there are, so it can't always plan policies effectively. Some 75 million homeless have no birth certificates, so they can't qualify for aid, register for school, get phone service, or open a bank account. Millions of other Indians have fake IDs to get assistance they're not entitled to.

Nandan M. Nilekani thinks he has a solution. The co-founder of IT outsourcer **Infosys** has been drafted by the government to run a new agency, the Unique Identification Authority. The UIA is an effort to create ID

(FROM TOP) ZHAO JUNCHAO/COLOR CHINA PHOTO/AP PHOTO; HALLDOR KOLBEINS/AFP/GETTY IMAGES

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numbers for all Indians, many of whom the state has missed. “If you are going to have all this [economic] growth,” says Nilekani, “people who are marginalized should be given a chance.” To make the system more secure, he wants to gather fingerprints from every Indian and store the prints on government servers.

A uniform ID system with biometric data, which should launch next year, could curb fraud and give millions of Indians access to aid. The program could “have a dramatic effect on poverty,” says Reuben Abraham, a professor at the Indian School of Business in Hyderabad.

It could also make many new commercial transactions possible by allowing online verification of identities by laptop and mobile phone. Indian banks, for example, will be able to operate in remote villages without building costly branches. A customer can go to the bank’s village agent—a grocer, say—get his fingerprint ID confirmed, and withdraw 500 rupees from his account. Once banks can serve all of India’s 600,000 villages, rural Indians will be able to save and borrow, an enormous benefit to the economy. Says Nilekani: “If we can give everybody a unique ID number, if you can get people a bank account, a mobile number, this gives them a leg up, a set of tools to meet their aspirations.” —*Bruce Einhorn*

The bottom line *The government has been slow to embrace IT. Nilekani’s biggest challenge will be overcoming bureaucratic inertia.*

Currencies

The Yuan Moves, Asia Follows

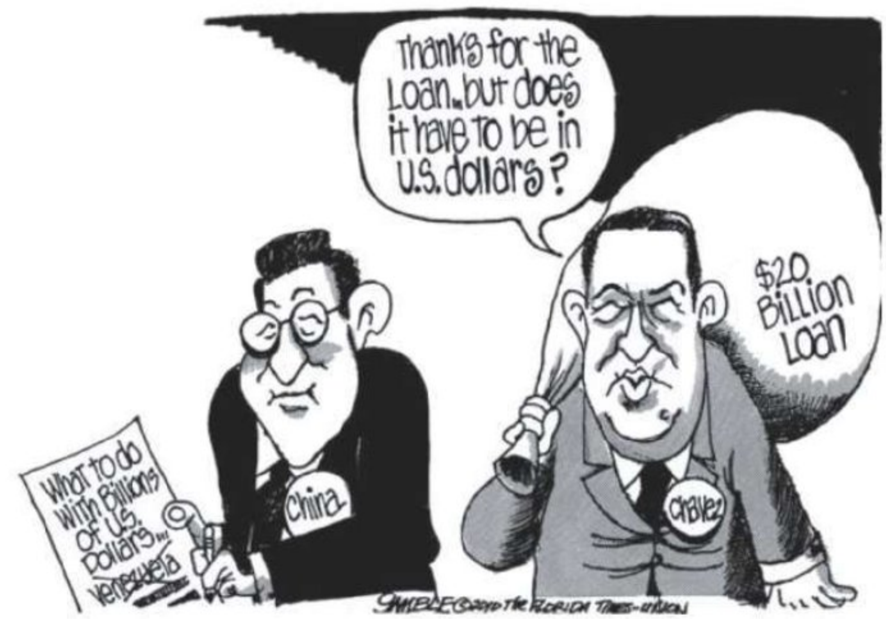
- **The region’s currencies are getting stronger as China mulls revaluation**
- **A more robust yuan means Beijing can afford to import more goods**

As China prepares to revalue the yuan, other Asian currencies are strengthening in anticipation. When Beijing makes its move, they’ll probably rise even more. “A Chinese appreciation will kick off tightening in the whole Asian complex of currencies,” says Richard Benson, who oversees $14 billion in currency funds at **Millennium Asset Management** in London.

Markets have seen this before. In 2005, the last time Beijing relaxed its foreign currency regime, the Singapore dollar, Indonesian rupiah, and Malaysian ringgit all climbed faster than the yuan. A sign of things to come: On Apr. 14 the Singapore Monetary Authority boosted the value of its dollar by 1.1% to cool the economy. First-quarter gross domestic product grew at an annualized rate of 13%. —*Bo Nielsen and Matthew Brown*

The bottom line *The Asian reaction to a likely yuan revaluation signals China’s growing strength—and the waning power of the dollar.*

Drawing Board



Tom Keene EconoChat

Tom talks with JPMorgan Chase Chief Economist **Bruce Kasman** about the economy and the outlook for jobs in the U.S.

You are optimistic about growth. But you see unemployment at 9.4% at the end of this year. We don’t get much job improvement, do we?
KASMAN: No, we don’t. I think what’s going on here is that companies cut back not just on jobs, they cut back on the workweek. Some of the gains we’re going to see in income ... are going to come because the workers that are working less hours are now being used more intensively. In addition, a lot of people left the workforce discouraged, and they are going to start coming back. It’s a slow grind on the unemployment rate. The labor market is going to be a powerful force pushing inflation lower.

We hear about the new normal. Is there a new productivity?
The jury is still out. Our own view is that the level of productivity stays higher, but growth of productivity starts to return to lower levels.

I do think a social contract has broken down here. Since the early 1980s margins have been expanding, but they have been expanding alongside greater job security for workers. Now we’ve had a situation through this recession, with the productivity gains and the dramatic job losses, where we’ve seen companies maintain their margins. But it’s at the expense of a very damaging hit ... to labor markets. [It] will heal gradually, but it ... has the risk of a political backlash in a world in which workers are going to be for a long period suffering from the events of this downturn.



Bloomberg Radio’s Keene hosts Bloomberg Surveillance *and* Bloomberg on the Economy.

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Gene Therapy Takes a Turn for the Better

▶ **Recent successes are giving drugmakers and patients hope**

▶ **"People were fed up with big promises and not seeing results"**



ILLUSTRATION BY CLAYTON JUNIOR

Jean Erickson, a former preschool director, suffers from Parkinson's disease. Her mobility was improved when doctors drilled a hole into her skull and injected a cold virus modified to help transport a gene into her brain.

The gene created a mini-factory within her cells to pump out dopamine, a chemical that regulates physical movement. "I stopped freezing up," says Erickson, whose treatment was part of research funded by **Genzyme.**

Successes like Erickson's are leading to a revival of interest in gene therapy, which had pretty much dropped off the medical map after the death 11 years ago of an 18-year-old patient. Genzyme and **Pfizer** in the U.S. and **Novartis** in Europe are leading the pack. There are currently 354 U.S. studies under way employing gene manipulation. That's up from 116 worldwide in 2008. San Jose (Calif.) researcher **Global Industry Analysts** forecasts that sales of gene-based therapies could exceed $465 million annually by the year 2015.

Recent advances in treating brain and eye disorders—and improvements in safety during trials—have led some researchers and investors to compare the current state of play in gene therapy to the early days of biotech: "There were lots of ups and downs, lots of believers and nonbelievers," says Nick Leschly, a partner in **Third Rock Ventures,** a lead investor in a $35 million round of financing for **Genetix,** a Cambridge (Mass.) startup. But "look at **Roche's Genentech** portfolio

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today: Avastin, Rituxan, and Herceptin. Right there, you've got $17 billion in sales. That's the kind of future we see for gene therapy over time.''

For drugmakers, the goal is to move gene therapy beyond advances against relatively small "above the neck" disorders toward mainstream illnesses, such as Alzheimer's, hypertension, and diabetes, that affect millions of patients globally. That's where Big Pharma makes its big money. "Now the real challenge is to choose the right targets, which diseases and, from a commercial point of view, which markets make sense," says Ronald Crystal, a researcher at Weill Cornell Medical College in New York who helped pioneer the field two decades ago.

Genes contain instructions for cells to make proteins that carry out chemical reactions in the body and help the immune system fight infections. When a gene is defective and can't make the correct protein, disease can occur. While conventional drugs use natural substances or chemicals to fight illness, gene therapy treats disease by replacing malfunctioning genes with healthy ones.

It was first used in the 1990s to treat 19 children with the so-called Bubble Boy disease, in which the immune system is unable to fight germs. While the children were saved, five later developed leukemia. A more devastating failure occurred in 1999 when 18-year-old Jesse Gelsinger died of a massive immune response within hours of being treated for liver disease. "Gene therapy was dead as a doornail," says Axel Polack, a general partner at **TVM Capital,** a venture capital firm. "No one was investing anymore. People were fed up with big promises and not seeing any results."

In recent trials, a different type of cold virus, which triggers milder immune responses, is being used to transmit genes into patients. That has helped fuel renewed interest in the therapy. Genzyme has invested "well north" of $200 million in gene therapy research over the past 10 years and now has more than 80 employees working on the technology, says Sam Wadsworth, a Genzyme group vice-president.

Other large drug companies are cementing partnerships. In January, Novartis licensed gene treatments for hearing loss and balance disorders from Maryland-based **GenVec,** in a deal worth up to $213 million. A month later, startup **Tacere Therapeutics** announced that Pfizer would license its hepatitis C treatment in an agreement valued at as much as $145 million.

Only China has approved gene therapies for actual medical use, for two types of cancers. The first U.S. approvals will come in about four years, predicts Philip Reilly, chief medical officer at Genetix, which hopes to market a French gene treatment to stop a rare form of progressive brain damage. Genzyme is launching larger trials of genetic treatments for Parkinson's and a form of macular degeneration that causes severe vision loss in 1.4 million Americans over age 40. The payoffs could be substantial: The market for Parkinson's drugs alone reached $3.6 billion in 2008.

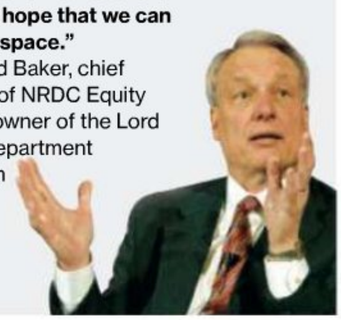
Still, gene therapy is unlikely to produce revenue for Genzyme or any company for several years, says **Cowen & Co.** analyst Phil Nadeau. "Over the long haul it's very intriguing and holds a lot of promise, particularly for some of the rare disorders," he says. "But there have been a lot of fits and starts and, from a public-market investment standpoint, it's still too early."

Not for 9-year-old Corey Haas of Hadley, N.Y. Since the 2008 gene therapy trial that gave him clearer vision in one eye, Haas says he can ride his bike and recognize colors. Now he wants doctors to go to work on his other eye. This year, he says, "I'm going into Little League." —*Rob Waters*

The bottom line *Researchers and investors are heartened by advances in gene therapy. Analysts say revenues are still several years off, however.*

Quoted

"We wait for other retailers to die and hope that we can take their space."
—Richard Baker, chief executive of NRDC Equity Partners, owner of the Lord & Taylor department store chain



Consumer Products

Pepsi's Plan to Make Litter Green



▸ **"Dream Machines" will offer reward points for plastic**

▸ **CEO Nooyi: "The follow-through hasn't been there"**

The U.S. beverage industry produced 224 billion bottles and other containers in 2008. Most of them ended up in gutters and wastebaskets. Even David P. Steiner, CEO of **Waste Management,** which runs 109 recycling facilities, concedes that he has tossed his three sons' empty bottles into a trash can when cleaning out his car at a gas station because no recycling bin was available. "We're not set up with the infrastructure to do what we want to do," he says.

Now, Waste Management is teaming up with **PepsiCo** and the nonprofit Keep America Beautiful to make it easier–and lucrative–to recycle. This year they will install several thousand "Dream Machines" to accept plastic bottles and cans at gas stations, convenience stores, and other areas. Jeremy Cage, who heads the project for PepsiCo, says he's trying to recover "the unreachable bottle"–those sipped from by customers outside the office or home. Adds PepsiCo CEO Indra Nooyi (above): "The follow-through hasn't been there."

Coca-Cola has also clambered aboard the green bandwagon. In 2009 it teamed up with **United Resource Recovery** to open the world's largest plant to recycle polyethylene terephthalate (PET) into new bottles. **Nestlé,** which owns Perrier, Poland Spring, and other water brands, forged a partnership with Waste Management last summer with recycling kiosks in about 70 **Whole Foods** stores.

Why would these big producers of litter go green? Public image, of course,

(FROM TOP) NEVILLE ELDER/CORBIS; DENNIS BRACK/BLOOMBERG

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Farm Equipment

The Perils of Running Lean

John Deere has kept inventories low compared to other farm equipment companies. That's great for profits. But some customers have turned to Deere"s competitors rather than risk receiving their machines after harvest is over.



* makes Cat Challenger tractor
** makes Case and New Holland equipment

DATA: BLOOMBERG, COMPANY REPORTS

but other forces are at play as well. Pepsi and other beverage companies make bottles out of PET, a petroleum product. When oil prices are high, it's more attractive to use recycled PET. (Pepsi leads the industry with about 10% recycled PET in its bottles.) The companies also don't like container deposit laws, now in 11 states, meant to spur recycling. Deposits are costly for bottlers and make drinks pricier for consumers. Then there is the good of the planet. "Environmentally, it's the right thing to do," says Nooyi, "and it's an incredible way to create a closed-loop system."

Still, altering behavior is hard. Cage and Nooyi both say "green is the new beige," with consumers so inundated with eco-friendly slogans that they become immune to them. So at least 3,000 of the machines will be computerized kiosks that give users points for each bottle or can they insert. Points can be redeemed for movie tickets and other rewards at Waste Management-owned Greenopolis.com. Pepsi will lease the machines from Waste Management and will pay the company to haul the containers away. As part of the program, PepsiCo will donate money to the nonprofit Entrepreneurship Bootcamp for Veterans with Disabilities. "It's not enough to benefit the environment," says Cage. "There has to be something in it for you." —*Diane Brady with Duane Stanford*

The bottom line *Offering rewards for bottles and cans may help Pepsi reach its goal of boosting U.S. beverage container recycling rates.*

Corporate Strategy

Low Inventory Angers John Deere Customers

- Some farmers bolt as recovery catches the equipment maker short
- "I suspect we can lose at least half a dozen deals a month"

Jay Armstrong just broke a 50-year family tradition at his Kansas farm: He bought his first major piece of equipment that's not a John Deere brand. The Italian-made corn harvesting combine attachment Armstrong ordered from **Dragotec USA** will arrive in May. The same $59,000 part from **Deere** wouldn't have been delivered until August. "I used to be blind to all colors but [Deere's] green and yellow," he says. "My color blindness is now gone."

In recent years, Deere has been focusing on becoming a build-to-order company. That bolstered prices and profit because keeping smaller stockpiles on hand reduces the amount of materials and working capital a company needs. But production cuts and the tightest inventories in the industry have led to a shortage of Deere equipment as the farm economy is strengthening. And that's pushing customers such as Armstrong toward competitors.

Deere shrank its inventory 28% in the 12 months ended on Jan. 31. As a percentage of sales in the most recent reported 12 months, Deere's inventory was just 12.3%, the lowest among 15 farm and construction equipment makers, including **Agco** and **Caterpillar**. Fewer products have big implications for the company's dealers. "It means I am losing market share,"

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Comcast
Company campaign money page 36 ▶

says Larry Southard, co-owner of a central Iowa dealership that gets 90% of its sales from Deere gear. He figures his dealership's sales would be up to 20% higher this year if it had enough inventory to meet customer demand and products were shipped more quickly. "I suspect we can lose at least half a dozen deals a month," Southard says.

One reason: A farmer who recently has ordered a tractor for crops such as corn and soybeans, which are harvested starting in September, may not be able to get the equipment until December or January, he says.

Ken Golden, a spokesman for Moline (Ill.)-based Deere, says the manufacturer's "intense focus" on managing inventory has improved its financial performance and has allowed it to design better products for customers. Deere's sharp-penciled ways certainly helped temper the hit to its profits during the recession, when sales declined for some equipment makers. Deere's 52% decline in trailing 12-month profit was smaller than Agco's 65% drop and Caterpillar's 75% plunge. "Deere is likely a little ahead [in managing its stocks]," says **UBS** analyst Henry Kirn, because it has "focused on taking inventories out of the channel and becoming leaner over time."

Deere Chief Financial Officer James M. Field said on a Feb. 18 conference call that the company had been too pessimistic about the effect of the global recession on North American farmers. In November, Deere predicted its net sales would decline about 1% in the year ahead after dropping 19% in the 12 months ended Oct. 31. Deere expected production tonnage to decrease 3%. In February the company revised its outlook upward, forecasting sales to increase up to 8% in 2010 as gains in farm cash receipts rise far more than expected.

Deere's Golden says the company is boosting production to match the improved orders. Still, Kansas farmer Armstrong says bad feelings may linger as a result of the company's inventory squeeze. "Deere's business plan of trying to control the supply vs. selling a product and providing a service is going to come back and haunt them," he says. —*Shruti Date Singh*

The bottom line *Inventory management is crucial in a slump. But maximizing profit without forgoing future sales is difficult as business strengthens.*

Retailing

New Frontiers for Luxury Goods

Move over, Paris. The longtime capital of luxe is no longer the only mecca for prosperous consumers seeking designer baubles. In a truly global economy, wealth–and luxury–know no borders.



DATA: COMPANY REPORTS

Media

Is the *Times* Ready For a Newspaper War?

▶ A new *Wall Street Journal* local section may win ads from the *NYT*

▶ "The *Times* will try to compete. ... But you have to pay Carlos first"

The newspaper business is a reliable investing trap. Just ask **McClatchy,** which in 2006 swallowed Knight Ridder only to see its stock fall from $50 to 50¢ before rebounding to $7. Even **News Corp.**'s Rupert Murdoch has had to write down $3 billion after paying $5.6 billion in 2007 for *The Wall Street Journal*.

Why, then, is Murdoch committing $30 million to launch *The Journal*'s New York section on Apr. 26? Because he sees an opening in his fight against **New York Times Co.,** which was so strapped for cash last year it had to pay Mexican industrialist Carlos Slim 14% for a $250 million loan; servicing the debt costs the Times $35 million a year. Advertising plunged 25% in 2009. Murdoch's move "is aimed at kicking the *Times* when it's down," says Alan D. Mutter, an influential media analyst and blogger. "The *Times* will try to compete with as much resource as it can muster. But you have to pay Carlos first."

A local section in *The Wall Street Journal* is a thrust at the Times' base, a chance to poach department store and luxury ads, explains Ronald Weintraub, the former publisher of *The New York Sun*, which took a shot at the market from 2002 to 2008. The *Times* has 44% of its weekday circulation in the New York City area; high-end retailers overwhelmingly place their newspaper ads in the daily. The *Journal* derives an es-

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timated 15% of its circulation from the region, so it is offering deep discounts for its Apr. 26 local launch. **Saks Fifth Avenue** has signed on.

"There's no question a price war with Rupert would hurt," says Moody's analyst John E. Puchalla, who argues that debt management is now the top priority for the business side as the paper pays for a decade of financial missteps. The *Times* has written off almost $1 billion of its assets over the past 10 years—about 38¢ for every dollar of capital, according to New Constructs, a research firm in Nashville. Rather than hoarding cash as the newspaper business declined, the *Times* paid out more than $400 million in dividends from 2005 to 2008.

In 2004 it sold its old headquarters for $175 million; the property was flipped for $525 million just three years later. In 2006 the paper reported a group's interest in buying *The Boston Globe,* which it acquired in 1993 for $1.1 billion, for at least $550 million. Management passed. It finally put the money-losing paper up for sale last year, only to cancel the auction. In 2007 the *Times* hiked its quarterly dividend by 31% and boasted of its high yield—then killed the payout in February 2009 to save $35 million (again, the amount of its annual interest payments to Carlos Slim). "The Slim deal is a transfer of wealth that never should have happened if they had managed their cash better over the years," says David Novosel, an analyst with researcher Gimme Credit. The *Times* declined to comment for this story; News Corp. would not discuss the details of its rollout.

Recently, investors have been sanguine about the Times. From a low in February 2009, its publicly traded stock has tripled, to $12.80 a share. Circulation is 959,000 on weekdays, while the Sulzbergers' supervoting shares shield the paper from raiders and activists. Yet according to data compiled by Bloomberg, the Times' balance sheet has little slack left. Cash is down to $36.5 million, compared with $56.8 million last year. The company has been lowering debt—from $1.06 billion to $769 million in the last year—but the burden remains high compared to its market capitalization of $1.86 billion. And management actually had to use the high-interest $250 million Slim loan to pay down debt that carried lower rates. Reinvestment has ground almost to a halt, while customer collection times have spiked.



Times Chairman Arthur Sulzberger Jr. had to accept an expensive loan for his troubled media company

All of which helps explain why Murdoch is pushing forward. "This could be a money-losing venture for the *Journal*," says Richard Dorfman, managing director of media investment shop Richard Alan, "but a potential big winner for Rupert if he's able to throw the *Times* over the edge of the abyss."

It's also Murdoch's idea of a good time. As he said at the National Press Club in April, "We've been involved in ... all type of media wars, yes, and I've enjoyed them." Even if he snatches away not a single Bloomingdale's ad, News Corp. will still have revenue more than 12 times that of the *Times*. That buys an awful lot of ink.

—*Roben Farzad*

The bottom line *Given its stretched finances, Times Co. can ill afford a costly war.*

Drawing Board

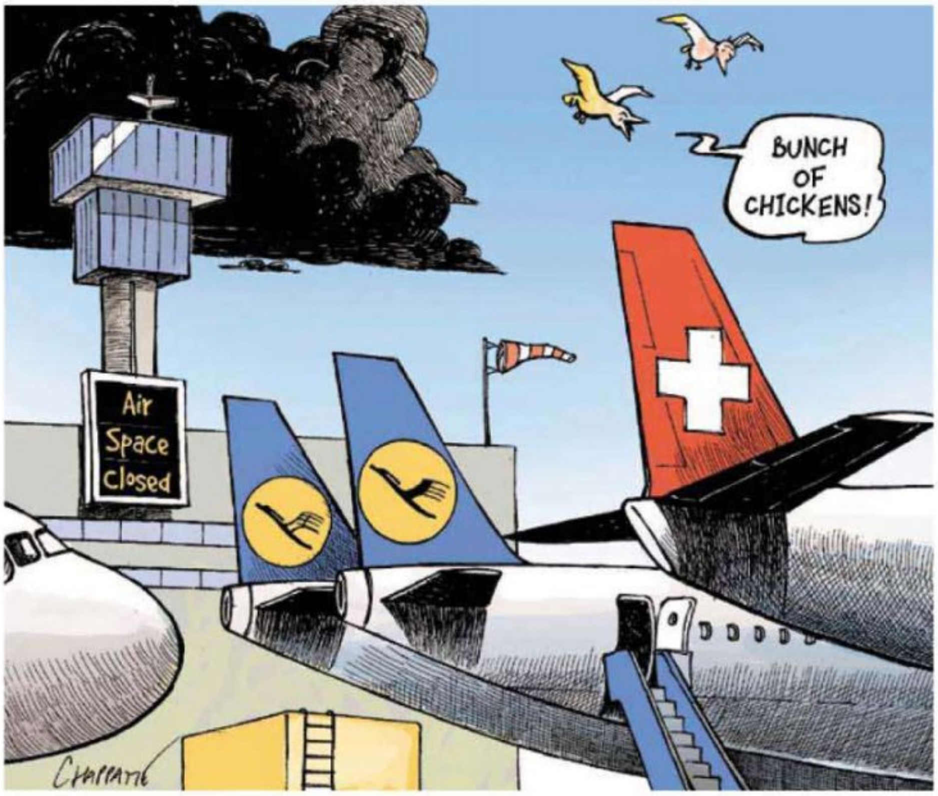


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Car Dynasties

A Fiat Heir's Bold Breakup Plan

- **New Chairman John Elkann could speed the carmaker's expansion**
- **"His appointment will make Fiat's governance similar to Ford's"**

For almost a century, the Agnelli family has been a symbol of Italy's wealth and industrial prowess. Yet in recent years, the top job at the family-controlled Fiat unit had been held by an outsider. No longer. On Apr. 20, **Fiat** named Agnelli heir and board member John Elkann to become chairman of Italy's biggest carmaker, replacing Luca Cordero di Montezemolo, who is retiring.

The 34-year-old scion assumes leadership at the Turin-based company, whose auto holdings include Fiat, Alfa Romeo, and Lancia, at a critical time. On Apr. 21, Fiat said it will break out its truck, tractor, and other industrial operations into a new unit, leaving its carmaking and car parts businesses in Fiat. The idea is

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to give the auto unit, run by CEO Sergio Marchionne, an independent identity that will make it easier for investors to value the company—and for the car company to raise capital and expand. Last June, Marchionne acquired 20% of Chrysler and became its CEO.

Fiat's new chairman, who's equally at ease in yachting whites and boardroom pinstripes, is expected to move more forcefully to expand the company's auto unit now that he's firmly in control. The Agnellis own 59% of Exor, a publicly listed investment company that in turns owns a controlling stake in the Fiat group. Elkann, the grandson of former Chairman Giovanni Agnelli II, has run the family holding company since Agnelli's death in 2003.

"Fiat ended a generational transition and the owners [have] come back to head the company," said Luigi Angeletti, head of the Italy's Union of Labor (UIL). Adds former Italian Prime Minister Romano Prodi: "Experience isn't his biggest strength. But he's a wise and intelligent guy."

Elkann backs the ambitions of Marchionne, who has said only the largest carmakers will survive in the long term, to turn Fiat into a larger global player through acquisitions. Although he bagged a stake in Chrysler, he unsuccessfully bid last year to buy General Motors' Opel unit in Germany.

By separating industrial operations from carmaking activities, which accounted for 56% of its 2009 sales, Marchionne may be able to move more quickly to sell shares and use the cash to pursue acquisitions and car industry alliances. "The spin-off is very positive for Fiat as it helps to bring out the value from the Italian carmaker," says Karim Bertoni, who helps manage $18.5 billion at Geneva-based Banque Syz.

Just how much Elkann will assert himself in his new role is unknown. Marchionne has been used to a large amount of management freedom, and few expect Elkann to change that. Predicts Prodi: "His appointment will make Fiat's governance similar to **Ford**'s, in which the management role is covered by businessmen, while the family covers only an institutional role." —*Sara Gay Forden and Tommaso Ebhardt*

The bottom line *A freed Fiat auto unit under Marchionne's control will be in a very acquisitive mood if it can raise the capital it needs.*



Handing out samples at a Beijing supermarket: The "Tang makes water more exciting" pitch has paid off

Global Marketing

Tang Gets a Second Rocket Ride

▸ **The Space Age drink soars in China and developing markets**

▸ **"Little grains of stuff that you pay decent money for"**

"Tang makes water more exciting." That marketing slogan probably wouldn't go down well in the U.S., where the powdered, tangerine-flavored drink has been around for half a century. But the Chinese are drinking it up—literally.

Kraft Foods saw sales of Tang in developing markets soar 30% last year, to more than $750 million, powered by Asia, Latin America, and Eastern Europe. "It's a product that's exceptionally well positioned in the current environment," says Kraft Chief Executive Officer Irene Rosenfeld.

The resurgence of Tang, once extolled as the beverage of American astronauts, is one payoff from Kraft's strategy of boosting overseas sales by targeting 10 so-called power brands—products the company identified in 2008 as being under-marketed and having the highest potential profit margins.

Also on the list are household names like Oreo cookies and Philadelphia cream cheese. "These 10 get a disproportionate amount of talent, R&D resource, as well as advertising and promotion," says Sanjay Khosla, who oversees Kraft's developing markets.



The two-year-old strategy is credited with raising revenues from developing markets to 21% of Kraft's $42.2 billion total last year, excluding cur-

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27
Million

Last year, Kraft distributed 27 million samples of Tang, up from 300,000 the previous year

rency fluctuation, divestitures, and acquisitions.

Kraft relied on market research to help refresh Tang's image overseas, where sales growth had stagnated. In China, where the brand was introduced 22 years ago, surveys showed that mothers believed their children needed about six glasses of water a day to be properly hydrated, says Shawn Warren, Kraft's vice-president for marketing for the Asia Pacific region. Children, however, saw water as "boring" and "bland," he said. That led to a new marketing plan built around the "Tang makes water more exciting" tagline.

From its research, Kraft also learned that the Chinese prefer powdered drinks by the glass rather than by the pitcher—likely a by-product of the country's one-child policy. So the Chicago area company developed a box of single-serve powder sticks in place of pitcher packs, which also had been too expensive for some Chinese consumers.

Kraft's country managers were also encouraged to experiment with new flavor combinations aimed at local palates. That gave rise to mango concoctions in the Philippines; *tuna*—a type of cactus fruit—and tamarind in Mexico; and *maracuja*, also known as passion fruit, in Brazil.

To introduce the new Tang flavors, Kraft distributed 27 million samples last year, up from 300,000 in 2008. Sales of Tang in Latin America jumped 42% in 2009, while sales in Asia Pacific grew 25%, says Khosla. That's a huge improvement over the previous year, when Tang averaged just a 4% sales increase across developing markets.

Even with the added investment in packaging and marketing, Kraft managed to keep Tang's profit margins at a sweet 37.2%. Says Alexia Howard, an analyst with Sanford C. Bernstein: "Powdered drinks are one of the most profitable products that Kraft has—little grains of stuff that you pay decent money for."
—Duane D. Stanford

The bottom line *With minimal product changes and a hefty dose of localized marketing, consumer goods makers increasingly take brands across borders.*

In brief

Oil, Ellison, Icahn—More



ExxonMobil's platform off the coast of California

ExxonMobil
Drill, Baby, Drill—Then Drill Some More

In oil, the name of the game these days is how long can you go. On Apr. 16, ExxonMobil said it had completed a well that reaches 7,000 feet below the sea and extends 6.3 miles across. That adds up to more than 37,000 feet, a North American record. Output from the well, which is off the coast of California, will be equivalent to 5.8 million barrels of oil per year.

Oracle
Larry Ellison Writes Another Big Check

The world's No. 2 software maker announced on Apr. 16 that it is buying Phase Forward for about $685 million. The Waltham (Mass.) company markets software that helps drug companies conduct clinical trials. Oracle CEO Larry Ellison (right) has spent some $42 billion over the past five years on acquisitions aimed at boosting the company's profile in industries such as retail, telecom, and now health care.



ArcelorMittal/Posco
A Declaration of Independence

Vertical integration is back in vogue in steel, as the industry tries to break the stranglehold of iron-ore and coal suppliers. ArcelorMittal, the world's No. 1 steelmaker, plans to triple output at its iron-ore mine in Brazil by 2014. South Korea's Posco, meanwhile, has earmarked $5 billion for investment in overseas mines. The race to find other sources of key materials has taken on new urgency as iron-ore producers have exploited their market power to dramatically raise prices.



Lionsgate
Icahn's Roars Get Louder

Billionaire investor Carl Icahn raised his hostile offer for Lionsgate from $6 to $7 a share on Apr. 15, in a bid to gain majority control of the independent film and TV production company. Icahn wants to boot out Lionsgate managers, whom he has criticized for trying to buy other Hollywood studios at a time when movie libraries are losing their value. Lionsgate says it's no longer in the bidding for Metro-Goldwyn-Mayer and has no designs on Walt Disney's Miramax unit.

EADS
Flying Solo on an Air Force Tanker Deal

The European consortium that is the parent of Airbus said on Apr. 20 that it plans to bid on a $35 billion contract to build aerial refueling tankers for the U.S. Air Force. There had been speculation that EADS might drop out of the contest after its junior partner, Northrop Grumman, pulled out in March. The pair beat out rival Boeing in a 2008 tender for the same contract, but the result was annulled after Boeing complained it had been unfairly disadvantaged. EADS has plans to build a plane assembly plant in Alabama as part of an effort to create a larger presence in the U.S.



Charles Schwab
Brokerage Settles With Investors

Charles Schwab has agreed to pay $200 million to settle claims that it misled investors on the amount of mortgage-backed securities held by its Schwab YieldPlus Fund, according to an Apr. 20 statement. A class action filed in 2008 alleged that the San Francisco-based brokerage incorrectly described the short-term bond fund, once the largest of its kind, as "safe." The case, in which plaintiffs sought damages of as much as $802 million, had been scheduled to go to trial in May.

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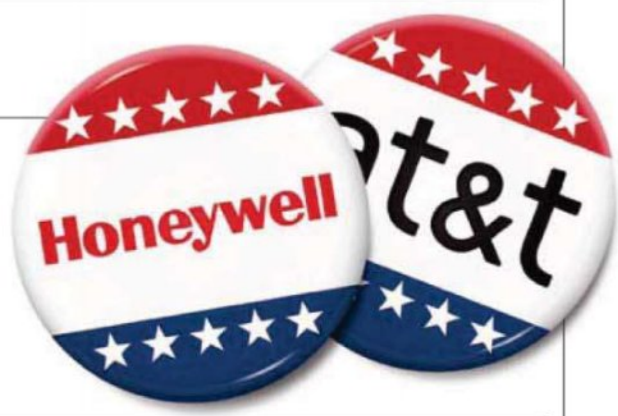
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Contents A Senate panel vote: A bad sign for Wall Street lobbyists? 38 ▶ Charlie Rose talks to Rahm Emanuel 41 ▶ Exit ramps from the White House: Who's likeliest to depart 42 ▶ Commentary: Family doctors deserve a hefty pay raise 44 ● Edited by Paula Dwyer and Brian Bremner

Why Companies Are Holding Fire



▶ The high court ruling on corporate campaign spending hasn't been a game-changer. Yet

▶ "Our phones are ringing off the hook," says one Washington lawyer

The Supreme Court's decision in *Citizens United v. Federal Election Commission* provoked condemnation as a decisive breach of the ramparts protecting U.S. politics from the influence of corporations and big labor. The hoopla, it's turning out, may have been hasty.

The ruling, issued Jan. 21 and denounced a week later by President Barack Obama in his State of the Union address, established that companies and unions may make unlimited expenditures advocating the election or defeat of federal candidates right up to Election Day. So far, though, it has not resulted in corporations rushing to set aside fresh money for campaign attack ads. To the contrary, the decision has provoked a backlash among Democrats in Congress. They are drafting disclosure legislation that could make it trickier for businesses to influence elections.

The only obvious winners in the immediate wake of *Citizens United* are well-connected Washington lawyers. "Our phones are ringing off the hook," says William J. McGinley, a partner with Patton Boggs, a corporate law-and-lobbying firm. "Pretty much every player in this town is trying to figure out what the decision means for them."

From a sunny office across 15th Street from the Treasury Dept. and White House, Kenneth A. Gross, a partner with the firm **Skadden, Arps, Slate, Meagher & Flom,** is also logging long, well-compensated hours. He's counseling wary Fortune 500 clients on how—or whether—to respond to the ruling in connection with this fall's midterm elections. "They're interested, curious, and want to know how to take advantage of it," says Gross, a former top in-house attorney at the FEC. But not a single major company, he continues, "has made a palpable move to take advantage of it. This is complicated for corporations—more complicated than all the hype would lead you to believe."

Let's sort it out. Comparing campaign ad spending to political speech protected by the First Amendment, the court majority ruled that companies and interest groups may spend as much as they like of their own money on political advocacy. As jurisprudence, this is a big deal. The justices overruled two prior Supreme Court opinions and struck down part of the bipartisan McCain-Feingold election law enacted in 2002.

Citizens United, however, may not live up to its initial billing as a political game-changer, predicts Nathaniel Persily, a professor of law and political science at Columbia Law School. It's the fourth in a series of decisions by the Roberts court that have narrowed or struck down campaign finance regulations. In 2007 the justices held that corporate and union ads enjoyed First Amendment protection as long as they didn't explicitly endorse or oppose candidates. "So before *Citizens United*, a company or a union could pay for ads that said, 'Tell Senator Smith to stop ruining America,'" Persily explains. "After *Citizens United*, they can add the magic words: 'and by the way, don't vote for Senator Smith.' That's not much of a practical difference."

With or without the Supreme Court's blessing, most big companies don't like to be identified as going after particular politicians, says Christopher DeLacy, a partner with **Holland & Knight.** "To jump directly into a political campaign is a risky move, especially if you pick the wrong candidate." (It remains illegal, by the way, for companies and unions to make direct or coordinated contributions to federal candidates or political parties.)

None of this is meant to minimize the extent to which special-interest money permeates American politics. In 2008, the Service Employees International Union, all on its own, laid out more than $70 million to help elect Obama and other Democrats, outspending even the U.S. Chamber of Commerce. This year, the chamber, the nation's best-funded busi-

Corporate Giving

Many companies already contribute the old-fashioned way, through political action committees. The top five corporate PACs, the total amount each gave in 2009, and examples of recipients.

Recipient	Company	Recipient
Senate candidate **Rob Portman** (R-Ohio)	**AT&T** $1.7 million	House Majority Leader **Steny Hoyer** (D-Md.)
Senate candidate **Roy Blunt** (R-Mo.)	**Honeywell** $1.6 million	Representative **John Adler** (D-N.J.)
Senate candidate **Mark Kirk** (R-Ill.)	**Boeing** $1.1 million	House Speaker **Nancy Pelosi** (D-Calif.) (*below*)
Representative **Kay Granger** (R-Tex.)	**Lockheed** $1.1 million	Senate candidate **Kendrick Meek** (D-Fla.)
House Republican Whip **Eric Cantor** (R-Va.)	**Comcast** $958,850	Senator **Kirsten Gillibrand** (D-N.Y.)

DATA: FEC, CENTER FOR RESPONSIVE POLITICS. ALL CANDIDATES RECEIVED $10,000 MAXIMUM ALLOWED FOR PAC CONTRIBUTIONS IN AN ELECTION CYCLE



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Zynga's Facebook strategy page 47 ▶

Drawing Board



ness lobby, says it plans to spend $50 million on political advertising—and the White House isn't even up for grabs.

Under existing law, companies can express themselves anonymously via contributions to the political war chests of nonprofit groups such as the Chamber. "The vast majority of corporate money will move through trade associations and independent organizations," says Michael E. Toner, a former Republican chairman of the FEC.

Citizens United will allow the chamber and the SEIU to be more direct in pushing their messages. Regardless of whether companies or unions chip in new money as a result of *Citizens United*, election ads likely will begin to surface in late summer. The business and finance lobbies are expected to try to chip away at the Democratic majorities in the Senate and House. Democrats such as Representatives Dina Titus of Nevada and Alan Grayson of Florida, both from highly contested districts, are thought to be vulnerable. "A lot of special interests are not happy," says Grayson, a sharp critic of Wall Street. "God only knows what they'll spend."

William C. Miller Jr., the chamber's senior vice-president for political affairs, says it anticipates focus-testing candidate-specific ads. "But talking about the issues and trying to inform voters are maybe more powerful," he says. "Dictating a vote may be too much."

In the arm wrestling that sometimes characterizes the relationship between Congress and the Supreme Court, companies' ability to act incognito under the auspices of industry groups could disappear. Democrats are preparing legislation in response to *Citizens United* that would require unions and business groups to identify who pays for ads designed to sway voter opinion. Charles E. Schumer of New York, a co-sponsor, says he already has broad Democratic backing in the Senate. He may not have far to look for Republican support: Four GOP senators—Susan Collins and Olympia Snowe of Maine, Richard Lugar of Indiana, and John McCain of Arizona—have criticized *Citizens United*.

The Chamber of Commerce's general counsel, Steven Law, says the Supreme Court's assertion of corporate speech rights would be turned on its head by the bill Schumer is drafting with Maryland Representative Chris Van Hollen. "*Citizens United* is being used as a pretext to pursue much broader regulations of the private sector in the political arena," Law argues.

There are other ways to capitalize on the ruling, says Greg Casey, president of the Business Industry Political Action Committee, another Washington group. Under *Citizens United*, companies should now feel free to recommend that their own employees vote for particular lawmakers, he asserts. "It is fair to assume that [employers] see this as an opportunity for public education, particularly about issues," Casey says. In late January, BIPAC held a conference call to discuss the ruling with representatives of member companies.

One of the participants, Devon Energy, will move cautiously, says William F. Whitsitt, senior vice-president of the Oklahoma City-based oil and natural gas producer. "A lot of us," he says, "are trying to understand what the implications of the ruling might be for big labor and for corporations like ours."

—*Paul M. Barrett and Jonathan D. Salant*

The bottom line *Companies likely will be wary about exploiting the recent Supreme Court ruling on corporate-financed election ads.*

Quoted

"It is not often you come across an issue where people of all political stripes come together so stridently.... Taxpayer bailouts of CEOs and companies is such an issue."
—GOP consultant Frank Luntz, in a January memo advising Republicans how to talk about financial reform



Financial Regulation

Time to Go Short on Wall Street Lobbyists

▶ **The White House wins one in the drive for financial reform**

▶ **"If you want to be a bank, then you need to be a bank"**

The high-profile government investigation of **Goldman Sachs** seems to have defanged Wall Street's once-formidable lobbyists, at least temporarily. On Apr. 21, the Obama Administration moved forward in its campaign to tighten the rules governing the financial industry when a Republican senator, Charles Grassley of Iowa, broke party ranks to vote with Democrats to impose strict limits on derivatives trading.

In a 13-8 tally, the Senate Agriculture Committee sent the derivatives measure to the floor. It would require, among other things, that ➜ 42

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Charlie Rose talks to

Rahm Emanuel



The President's Chief of Staff talks about the prospects for financial reform and middle-class anger in an edited version of an Apr. 19 TV interview

Will you get Republican votes for financial reform?
Yes. I think it will be bipartisan because people realize we have a financial system that over the last 20 years has raced ahead of the regulatory system. We have a multi-trillion-dollar section of the financial marketplace without an agency that oversees it. I mean, Warren Buffett ... has talked about derivatives as the equivalent of a nuclear bomb in the financial sector. Take a look at how derivatives have exploded in scope, scale, and size. And yet nobody knows what's going on. They happen in the shadows of the financial industry. It is unhealthy to not bring in some standardization and transparency. Even people in the industry believe that should happen.

Does the SEC complaint against Goldman Sachs make the case for reform easier?
Look, the same forces that were opposed to [reform] are still opposed to it. They are the same forces that have been hiring people to try to prevent the legislation or weaken parts of it—and they're still going to do that.

How would you describe President Obama's philosophy about the role of government?
Well, he is a pragmatist. He has adopted ideas and policies from Republicans and Democrats. He is not wedded to a philosophy or ideology. He sees government mainly for setting rules and then letting the private sector operate within those rules.

How deep is the anger in America?
I think it's deep, [but] there are a lot of factors that go into that, principally economic anxiety. We're in the middle of a severe economic transition.

Can Obama turn around the anger of people who think they haven't been heard?
There are legitimate reasons for the anger out there. The middle class has seen their incomes lost and cost of living go up while those at the top acted with a sense of irresponsibility that led to the economic crisis. Now the hard-working middle class is bailing out [the economy]. Anybody who thinks the anger is just being pumped up, doesn't get it.

You've got to listen to the people.
Yeah. Representative democracy [means those who are angry] have to be heard, too. When you have a leadership role, you have a responsibility ... to let disagreements flourish without letting those disagreements touch something on the darker side. Everybody is accountable, including the media.

Are you angry about the media?
No. But sometimes the media doesn't act with the full responsibility that comes with its position. They play a role in exacerbating the sense that America's pulled apart, and it's not as pulled apart as is being reported.

Are Rush Limbaugh and Glenn Beck pulling America apart?
I wouldn't limit it to them, but I think they ... do play a role in exacerbating tensions. And that could be also said about some on the left.

Would we be better off today, with lower unemployment, if the Administration had just focused on the economy?
I don't think the recovery would be in a stronger position. [The President said] we can go from every bubble you want to every bust you want, or we can lay a new [economic] foundation.

Is the Democratic Party in trouble in the election coming up?
Yeah, it's got challenges.

With unemployment at 9.5% or 10%, will it lose the Congress?
Unemployment is important. But if people think the economy is getting better, and we make this a choice about what led us into the recession and the set of policy changes we made to help lead us out, I think we have a chance of turning this election around.

Is there any other job in government you'd like to have?
Let me say it this way: I hope Mayor [Richard] Daley seeks reelection. I will work and support him if he seeks reelection. But if he doesn't, one day I would like to run for mayor of Chicago. That's always been an aspiration of mine. What I miss is being in touch with people.

When might we have a Supreme Court nominee?
The President nominated Sonia Sotomayor at the end of May [2009], and the Senate confirmed her the first week in August, so that's kind of your time frame.

Do you expect a confirmation battle in the Senate?
There will be a huge, huge battle. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

(TOP) CHRISTOPHER MORRIS/VII

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The Administration

Reshuffle in Obama Land?

A White House job is a career pinnacle, but sometimes it can be too much of a good thing. "Most people last 18 months," says Erskine Bowles, a former chief of staff to President Clinton. "It's the most exhausting, most comprehensive experience in your life." This means President Obama is likely to see some high-profile exits by yearend. Below is a handicapper's guide to departures, based on interviews with top White House officials and their associates. —*Hans Nichols and Julianna Goldman*

	Larry Summers Director, National Economic Council	**Peter Orszag** Director, Office of Management & Budget	**Robert Gates** Defense Secretary	**Rahm Emanuel** White House Chief of Staff	**David Axelrod** White House Senior Advisor
					
Probability of leaving by yearend	**60%**	**50%**	**40%**	**30%**	**20%**
Why he would leave	Summers, 55, has told friends that he's unhappy about his White House role, and he didn't get the coveted Fed chairmanship.	Orszag's soon-to-be second wife lives in New York; at 41, he may desire a private-sector job—and salary. He was about to leave when Obama insisted he stay.	After managing two wars since 2006, Gates, 66, is eager to retreat to his home near Seattle but may stay until the first Afghan troop withdrawals in July 2011.	He'll probably stay until mid-2011. If Chicago Mayor Richard M. Daley doesn't run in 2011—and friends say he likely will—Emanuel, 50, would jump in.	Axelrod, 55, went right from the campaign to the White House with little downtime. His wife, Susan, remained in Chicago. He is likely to stay until mid-2011.
Who might replace him	Ex-Fed Governor Alan Blinder; Roger Altman, co-chairman of Evercore Partners; National Economic Council Deputy Director Jason Furman.	Fiscal hawks: Robert Greenstein, director of the Center on Budget & Policy Priorities; Urban Institute President Robert Reischauer.	Obama may turn to Senator Jack Reed (D-R.I.), who could demur for family reasons, or former Senator Chuck Hagel (R-Neb.).	Tom Daschle, ex-Senate majority leader; Emanuel aide Phil Schiliro; Tom Donilon, deputy national security advisor.	Obama would almost certainly turn to trusted insiders such as Press Secretary Robert Gibbs or former campaign manager David Plouffe.
Why he matters	Obama sees him as the leader of his economic brain trust. He was a crucial player in helping to right the economy after the financial crisis.	He prepared Obama's $3.8 trillion fiscal 2011 budget and was a key policy architect of the stimulus and health-care bills.	He has earned Obama's trust, led a turnaround in Iraq, and forced the Pentagon to give up speculative, costly high-tech toys.	One of the most powerful Presidential aides in decades. Devised winning strategies to pass the stimulus plan and health-care reform.	Nobody else has his political savvy and personal relationship with Obama. He likely will be a top 2012 campaign strategist.

➔ Wall Street traders use clearinghouses to process deals and collect collateral to back up trades. It will be folded into a larger financial reform bill that was expected to be debated within days. Risky derivatives trading is what the Securities & Exchange Commission's lawsuit against Goldman is all about.

Grassley's support of a broader bill isn't a sure thing, but his defection may mean more GOP support for the White House, and the 60 votes needed to approve Obama's proposal. The Goldman news helps Obama, and as *Bloomberg Businessweek* went to press, he was set to turn up the volume on financial reform on in Apr. 22 speech in New York.

Wall Street may not be able to halt reform as it has in the past. "Three years ago, AIG would have been up here lobbying for some sort of exemption in this derivatives proposal," says Michael Greenberger, a former official at the Commodity Futures Trading Commission and now a professor at the University of Maryland School of Law.

Wall Street has far fewer friends in Washington these days among pro-business Democrats and Republicans. Senator Blanche Lincoln, the moderate Arkansas Democrat who heads the agriculture panel and faces a tough Democratic primary this summer, sponsored the derivatives measure, which goes beyond what the White House sought. Much to the horror of bank lobbyists, Lincoln's plan would force commercial banks to spin off their derivatives trading desks or lose Federal Deposit Insurance Corp. protection on their deposits. Goldman, **JPMorgan Chase, Bank of America,** and other banks where derivatives are a major profit center would not be able to tap cheap financing available through the Federal Reserve. (Her proposal would let Treasury exempt foreign currency derivative trading.) "If you want to be a bank, then you need to be a bank," Lincoln said at a Washington news conference before the vote.
—*Phil Mattingly*

The bottom line *A GOP senator's support for a tough derivatives bill suggests President Obama may have momentum for broader regulation overhaul.*

(L TO R) BRENDAN SMIALOWSKI/BLOOMBERG; RON SACHS/POLARIS; MANUEL BALCE CENETA/AP PHOTO; ALEX WONG/GETTY IMAGES; ALEX BRANDON/AP PHOTO

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Admittedly, money is harder to come by these days, but when the air is cleared of hyperbole and rhetoric, a persuasive case for business aircraft emerges. For starters, we are currently experiencing historic low rates for quality borrowers. And, with commercial air travel becoming less viable every day, the competitive advantages of a business aircraft become even more apparent, and quantifiable. History shows seven out of ten companies bold enough to invest during a downturn hold onto their market gains when the economy recovers. Leaving only one additional statistic to ponder: Cessna has more repeat customers than any other aircraft manufacturer in the world. All of which is why buying a Cessna today may be the most prudent business decision you will make this year.
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James Warren

For Health Care to Work, These Doctors Need a Big Raise



ILLUSTRATION BY NOMA BAR

Specialists earn $3.5 million more, on average, than general practitioners over the course of a career. A federal panel wants to reduce the discrepancy

The DoubleTree Hotel in Bethesda, Md., is an odd place to get beyond the utter irrelevance of much of the health-care debate. Yet on Apr. 22 and 23, as *Bloomberg Businessweek* went to press, the Council on Graduate Medical Education, a little-known federal panel, was set to recommend a dramatic change in the doctor workforce that treats Americans of all political parties.

The council was created—and statutorily mandated—in 1981. It's made up of a cross section of physicians, including representatives from the private sector, academe, the Veterans Affairs Dept., and Medicare. The council's reports are taken seriously by the private sector and government; in 1997 its members suggested a cap on the overall number of medical residents as part of federal cost cuts. And so it was done. Its 2010 recommendation could have just as much impact: Increase the number of primary-care physicians—and pay them a whole lot more.

To understand why this makes sense, I followed the council chairman, Dr. Russell Robertson, during his volunteer rounds at CommunityHealth, the largest free clinic in Illinois. It serves a poor, uninsured clientele of mostly Latinos and Poles—many undocumented, nobody asks—in a diverse working-class section of Chicago.

Robertson, the chairman of family and community medicine at the Feinberg School of Medicine at Northwestern University, spent 2½ hours treating five patients with chronic multisystem diseases: hypertension, diabetes, high cholesterol, obesity, and depression. A rotten economy spawned a 33% surge in patients last year, for a total of 22,000 visits. The wait for an appointment with one of the clinic's 300 volunteer doctors is six weeks.

One thirtysomething man needed antidepressants and a social worker. Another patient was off her medication for high blood pressure. A third had constipation tied to a thyroid condition. A 19-year-old woman was panicked by a sister with multiple sclerosis and, after her father's death from a heart attack, became convinced she also had heart problems and MS. Robertson gave her an electrocardiogram, antidepressants, and reassurance.

None of these conditions is imminently life-threatening or makes for particularly sexy medicine. Yet when the Obama health plan kicks in and a wave of newly insured patients goes for treatment, the system will be congested with these kinds of rudimentary ailments. Primary-care doctors comprise 32% of the physician workforce. Factor out pediatricians and just over 23% of doctors deal with adults, and that number is shrinking, says the Altarum Institute, a nonprofit health-care consultancy.

Why doctors choose to practice general medicine or specialize is a personal matter. Some dermatologists just love skin diseases. Others may like money. A family physician or general internist averages about $160,000 a year, according to the nonprofit Robert Graham Center, which researches primary care. A specialist averages $267,000. That means the general practitioner will earn about $3.5 million less over a lifetime.

Medicare determines the baseline for doctors' pay, and since most medical students elect to train in the non-primary-care jobs generating the majority of charges, procedure-oriented specialists end up the winners. Medicare finances the system via direct subsidies to pay residents' salaries and indirect payments to hospitals for tests and other duties fulfilled by residents. There's no inherent logic to the payments. Some New York City hospitals get over $200,000 per resident. Robertson's gets $60,000.

Other factors affect the general practitioner shortage, from a med school culture that considers it more glamorous to be an orthopedic surgeon or anesthesiologist—not to mention more advantageous to pay back student loans—to the media's fascination with obscure diseases. (Goodbye *Marcus Welby, M.D.*, hello *House*.) The result is a system ill suited to our needs.

The panel is calling for a 40% hike in the number of primary-care doctors—and a 40% income increase for those entering the field. That should get general practitioners to within 70% of the median income of specialty physicians. "Policy changes should be dramatic to remedy these legacy biases and have immediate effect," states a council draft.

I talked to Robertson again on a day when he saw four more patients. He personifies selflessness, yet at the end of the day he admitted his frustration. "Primary care is the bargain of the century, given that prevention and maintenance is a whole lot cheaper than intervention," said Robertson. It should be "like motherhood and apple pie." Ⓑ

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GE Capital helped keep Esmark Steel in the family.

Jim Bouchard says he knew what he wanted to do the day he toured a steel mill with his father at age five. So when Jim called his brother Craig and said, "Let's go build a steel company," no one was surprised. In 2003, the brothers started Illinois-based Esmark with just two employees, but it quickly grew to become the fourth-largest American steel company with over 3,600 employees by 2008. GE Capital stood by the brothers as they expanded their business, providing growth capital during a challenging time. Every day, GE Capital provides critical financing to thousands of companies, helping support jobs and local economies.

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Zynga and Facebook. It's Complicated

▶ **The game company can keep growing as long as it stays in Facebook's good graces**

▶ **"The next three years are a hell of a lot harder than the last three"**

More than 120 million people play **Zynga**'s online games. Employee headcount has almost quadrupled in the past year, to 775. Revenue for the three-year-old company should surpass $450 million in 2010, according to two people who have been briefed on its financials.

Mind you, Zynga's games are free. Revenue mostly comes from selling virtual hoes and machine guns and such to players of FarmVille, Mafia Wars, and other titles. "Only a few companies are so privileged to get the rocketship growth that Zynga has," says Reid Hoffman, co-founder of **LinkedIn** and a Zynga director and investor. As for an initial public offering, "All options are on the table," he says.

In an interview at Zynga's overflowing offices in San Francisco, Mark Pincus, the company's 44-year-old founder and CEO, seems giddy. "It's fun," he says, swiveling back and forth in a conference room chair. "It's adrenaline."

It's a sweet gig—although there's one big unknown: **Facebook.** Zynga's success depends on the good graces of the social network, where almost all of its games are played. "The single biggest challenge is managing growth in the face of total uncertainty," says Pincus. By all accounts he's on friendly terms with Facebook founder Mark Zuckerberg—who has shown a willingness to knock heads.

In March the social network stopped letting Zynga and other app creators promote games in the "notifications" menu users see each time they log on. Facebook said users were complaining about spam-like messages that appeared every time one of their game-playing friends found a baby duck or whacked a mobster. One protest group on Facebook with more than 5 million users called itself "I Don't Care About Your Farm, Or Your Fish, Or Your Park, Or Your Mafia!!!"



CEO Pincus launched Zynga three years ago. Now the company has revenue of $450 million

PHOTOGRAPH BY ROBYN TWOMEY FOR BLOOMBERG BUSINESSWEEK

Pincus says the policy change has hurt his business in "the short term" by slowing traffic to his games in the first quarter of this year. Still, he says, Zynga and Facebook can help each other, since his company's wares increase the time and attention users spend on the social network. He compares the relationship to that of a cable company and a hit-making network: "I think it benefits Facebook's users if we can create the next *Sopranos* and if we can be a brand, like **HBO,** that their customers really want." (Pincus is a minority investor in Facebook. All he'll say about his stake is that it's "basis points.")

Facebook doesn't just get happier users, it also gets big checks from Zynga. Any time a game looks like a potential hit, Pincus says his company deploys millions of dollars on ads promoting it to members of the social network. In total, Zynga spends between $5 million and $8 million per month for banner ads on Facebook, according to NeXt Up! Research. The aggressive promotions make it difficult for rivals to copy an idea for a game and make it as successful as Zynga's version, says Lisa Marino, chief revenue officer of app startup **RockYou.** "Social gaming is a math equation," says

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Technology



Facebook's Friends

Revenues are soaring for makers of apps that run on the 400 million-member social network. Players to watch:

Company	Est. 2010 revenue	Game registrations	Biggest hit
Zynga	$450 million[1]	253 million	FarmVille
RockYou	$80–$100 million[2]	71 million	Zoo World
Electronic Arts	$100 million[3]	58 million	Pet Society
CrowdStar	$100 million[2]	47 million	Happy Aquarium
Playdom	$100 million[2]	39 million	Social City
Slide	$30-$50 million[1]	21 million	FunSpace
Digital Chocolate	$30-$40 million[1]	2.1 million	MMA Pro Fighter



SOURCES: REGISTRATION DATA FROM APPDATA
(1) *BLOOMBERG BUSINESSWEEK* REPORTING
(2) COMPANY DATA (3) WEDBUSH MORGAN SECURITIES

Marino. "When you put millions of dollars down to protect [a franchise], you will win it."

Facebook could force Zynga to adjust its math. More than 90% of the company's revenues come from users converting real cash into proprietary virtual currency. FarmVille, for example, has Farm Coins. Say you buy a tractor for 5,000 Farm Coins, which equals about $3.30. Typically the company pays less than 10% of that to a third-party transaction handler such as **PayPal** and keeps the rest. (In March, PayPal said Zynga was its second-largest merchant after **eBay.**)

Facebook is testing a service called Facebook Credits that would offer a single virtual currency for use on many different apps. If the social network forces app makers to use Facebook Credits, as some developers expect will happen this year, Zynga would have to pay the company up to 30% of every transaction. "If Credits become pervasive, I don't think Pincus can stop it. It's going to hit the margin," says Peter Relan, executive chairman of **CrowdStar,** one of Zynga's many competitors.

"There's just going to be one currency that people use" on all apps, Zuckerberg told Bloomberg TV on Apr. 21. He didn't say when Credits might become mandatory. Pincus is trying out the currency as an option in FarmVille and other games. "There is definite value for users and developers in having the trusted Facebook brand associated with buying virtual goods," he says.

Pincus says he's eyeing other ways to get his games in front of the masses. **Apple**'s announcement on Apr. 8 that it plans to include a program for connecting people in social games played on the iPhone and iPad caught his attention: "It would make a lot of sense for Apple to be interested in doing more to enable social gaming," he says.

For now, Zynga's mission is to keep cranking out those Facebook hits. Work is going on around the clock; Pincus is encouraging employees to develop pet projects during weekend-long programming marathons. And, of course, the company is hiring like crazy. To help fill 300 job openings, it's running an ad on a billboard in San Francisco and has bought local public-radio sponsorships.

Pincus will need all the intensity he can get. **Electronic Arts** upped the ante in November when it bought Zynga rival Playfish for $275 million. "Zynga is riding high," says Barry Cottle, general manager of EA's interactive unit. "But they may soon find out that the next three years are a hell of a lot harder than the last three." *—Douglas MacMillan*

The bottom line *As long as Zynga keeps supplying Facebook with hit games—and ad revenue—this could be a long and profitable partnership.*

Quoted

"It has come to our attention that Gizmodo is currently in possession of a device that belongs to Apple.... Please let me know where to pick up the unit."



—Apple General Counsel Bruce Sewell in a letter to the tech blog, which paid $5,000 for an iPhone prototype left in a bar by an Apple engineer

Supply Management

A Wobbly Global Debut For Apple's iPad

▶ Asian suppliers of touchscreens can't keep up with demand

▶ "It has shocked us, the levels of demand"

The launch of **Apple**'s iPad has been one of the most heralded in techdom, and the early consumer enthusiasm over the tablet computer that surfs the Web, features e-books, and plays music and videos is powering sales. Yet Apple's image as a flawless marketing machine aside, this has hardly been a smooth product debut. Glitches ranging from a bizarre product ban in Israel to supply management issues in Asia have created challenges for the Cupertino (Calif.)-based company (page 92).

The iPad is certainly on a steep sales trajectory. Apple sold 500,000 iPads the first week after its early April debut. "It has shocked us, the levels of demand, at least initially," Chief Operating Officer Tim Cook told analysts during an Apr. 20 conference call after the company reported a 90% jump in quarterly earnings, to $3.1 billion, on revenues of $13.5 billion.

In markets outside the U.S., however, Apple has pushed back the iPad's release by a month until the end of May. It blames the delay on unexpectedly high demand, but analysts think Apple is having a hard time managing the production flow of the tablet computer's 9.7-inch (25-centimeter) touch-sensitive liquid-crystal display.

The big screen is far trickier to produce on a mass scale than the 3.5-inch display used on Apple's popular iPhone, says Andrew Rassweiler, an analyst with market research company iSuppli in El Segundo, Calif. "We understand that the yields on the display have been low and that they're creating a production bottleneck," Rassweiler says. Neither Apple nor touch screen manufacturers such as South Korea's **LG Display** and **Samsung Electronics** or Japan's **Seiko Epson** would comment on supply-chain issues.

Apple is having a different kind of problem in Israel. Customs officials in Tel Aviv this week have been seizing iPads from airline passengers entering the country. The device doesn't comply with Israeli

→ 51

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wireless standards, according to an Israeli Communications Ministry spokesman. Apple maintains that the iPad complies with the international standards for Wi-Fi frequency specifications.

You may not find many iPads on at least two American university campuses. Princeton University won't allow its students to use the device on campus Wi-Fi networks because of data security worries. George Washington University says the iPad won't work on its wireless network until an Apple software upgrade arrives in the fall.

Apple has run into manufacturing problems on some of its products before, including its MacBook notebook computers and iMac desktops, says Shaw Wu, an industry analyst with Kaufman Brothers in San Francisco. It looks like Apple will need to make some early-course production adjustments this time around as well.
—Arik Hesseldahl and Connie Guglielmo

***The bottom line** Apple will need to untangle its supply problems to keep up with demand once it starts selling the iPad globally.*

Consumer Electronics

How Vizio Beat Sony in High-Def TV



▸ **CEO Wang got suppliers to take equity stakes in his startup**

▸ **"The Vizio brand has become a force to be reckoned with"**

William Wang's corner office at the headquarters of electronics maker **Vizio** is the picture of luxury. Seven giant flat-screen televisions adorn the walls behind Italian leather chairs. Bottles shimmer at a full wet bar. Vizio may have been founded on low prices, the chief executive officer says, but he wants it recognized as a success story.

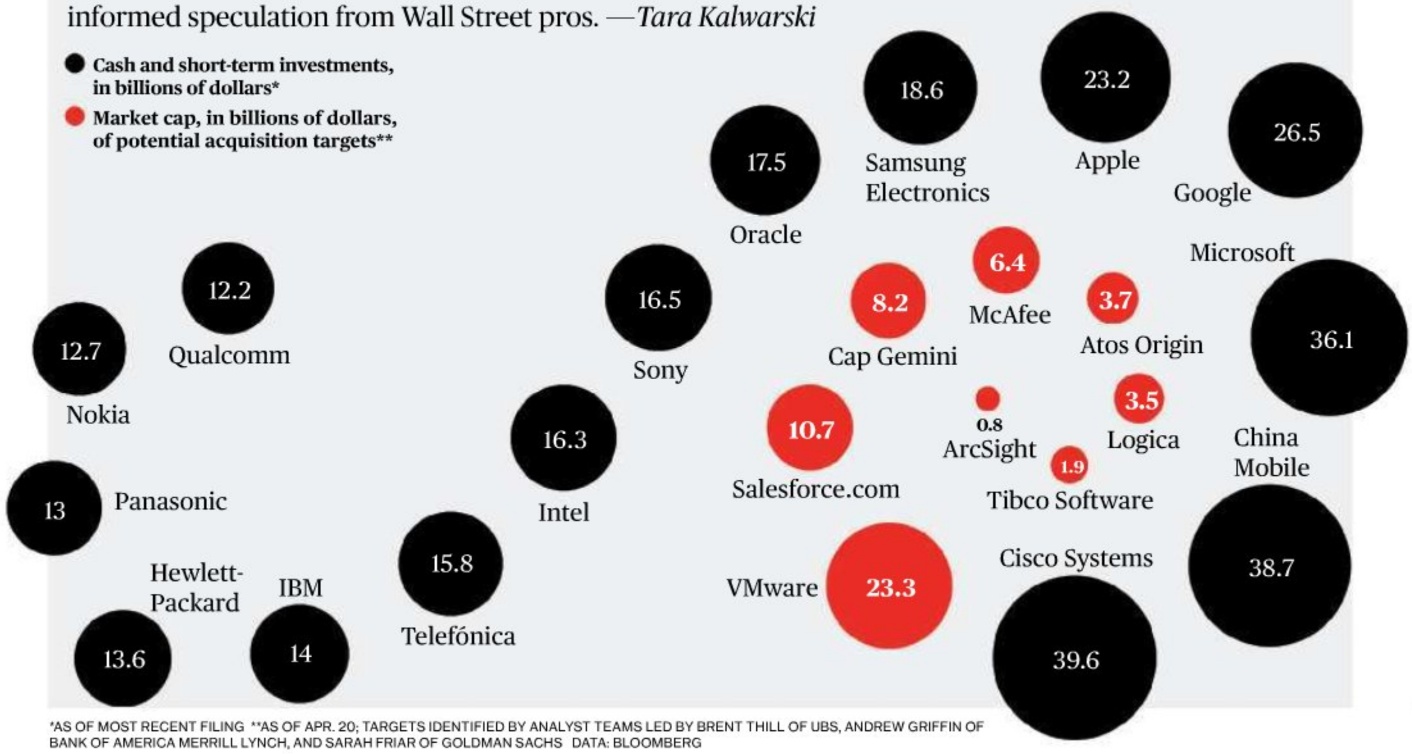
After seven years in business, the company just surpassed **Sony** to become the second-largest TV brand in the U.S. and is closing in on **Samsung**, according to industry tracker iSuppli. Vizio, based in Irvine, Calif., is on track to sell more than 6 million of its bargain-priced LCD TVs this year, up from 3.6 million in 2008. "The Vizio brand has become a force to be reckoned with," says iSuppli analyst Riddhi Patel.

"Our model is definitely a child of the 21st century," says Wang, 46. In the 1990s, the Taiwanese-born entrepreneur, who once ran the now defunct computer-monitor company Princeton Graphics, started Vizio in 2003 with $600,000, no engineers, and no factories. He parlayed relationships with Asian manufacturers into shelf space at U.S. retailers. The company made its mark by introducing HD sets at **Costco** for $3,000, a third of the price of Sony, **Panasonic**, and others. Rivals cited inferior quality; consumers didn't care. "With digital TVs, it's become

Numbers

The Great Technology Cash Pile of 2010

The top 15 cash-rich companies in tech have a total of $316 billion sitting in their vaults. That could point to a coming acquisition spree. Who is buying, and where are they setting their sights? Below, some informed speculation from Wall Street pros. *—Tara Kalwarski*



*AS OF MOST RECENT FILING **AS OF APR. 20; TARGETS IDENTIFIED BY ANALYST TEAMS LED BY BRENT THILL OF UBS, ANDREW GRIFFIN OF BANK OF AMERICA MERRILL LYNCH, AND SARAH FRIAR OF GOLDMAN SACHS DATA: BLOOMBERG

(TOP) HUGH HAMILTON

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Technology

Private equity's fashion faux pas page 61 ▶



4.7

BILLION DOLLARS

Venture capital investment in U.S. companies, first quarter of 2010. Up 12% from one year earlier

DATA: DOW JONES VENTURE SOURCE

harder to distinguish yourself as a premium brand," says Stan Glasgow, president of Sony Electronics' U.S. division.

Wang says what made his low-price approach work was recognizing that TVs are following the path of PCs, and that he needed to become a Michael Dell-like master of his supply chain. Wang went further than just securing good prices for parts and shipping. He offered two huge Taiwanese contract manufacturers, **Foxconn** and **AmTRAN Technology**, equity stakes in his company to ensure their attention. They bit. That enabled Vizio to deliver inexpensive sets to Costco, **Wal-Mart**, and other chains, and Wang's startup quickly gained market share.

Now, Vizio is going after Bluetooth headsets, portable TVs, iPod docks, and a type of stereo speaker called sound bars. It'll back the effort with a $30 million marketing campaign, featuring Beyoncé, aimed at showing shoppers that Vizio can offer gear as good as the top brands at much lower prices.

New products from Samsung and other rivals will keep the pressure on Vizio. Glasgow says the 3D sets Sony is shipping in June (page 127) will be better than Vizio's offerings. As for any possible newcomers—for example, a major retailer that decides to launch its own line of HD sets, as **Best Buy** has done—analysts say Vizio's supply-chain efficiency would be difficult to duplicate. "That's an expensive barrier to entry," says Tim Bajarin, president of technology consultancy Creative Strategies.

The privately held company doesn't disclose profits but says it has operating margins of 4% on $2 billion in revenue. (Sony has been losing money on TVs for more than a year, according to filings.) Wang says an IPO is likely, though not "in the next few months."

Wang says Vizio will keep growing by coming up with ways to undercut the colossi. He is not wanting for confidence. "Hey, before I was 30 years old, I made my first million," he says. "Before I was 40, I lost my first $40 million." —*Cliff Edwards*

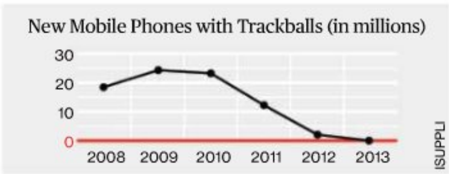
The bottom line *Vizio's business model—supply-chain mastery and low-priced products—would be difficult for any competitor to replicate.*

Smartphones

The End is Near for BlackBerry's Trackball

▶ The rollers collect grit and break down. Fans still love them

▶ "They need them fixed—'Now!'" says a repairman



The BlackBerry trackball, introduced in 2006, has always had issues. It accumulates grit and gunk. Commerce slows, communication cuts off.

Still, millions love their trackballs.

In 2008, Tony Naftchi lost his job as an auto-finance manager and started Fixyourberry.co m from a small office on New York's 7th Ave. A stream of bankers, fashion models, and other high-end BlackBerry addicts pay $30 a pop for Naftchi's new trackballs. "They need them fixed—'Now!'" the repairman says.

In the ever-morphing market for digital gadgetry, it should come as no surprise that the little sphere, flawed and strangely beloved, faces obsolescence. Trackball shipments in 2010 are expected to fall short of last year's peak of 25 million, says Tina Teng, a senior analyst for iSuppli's wireless group. The last trackballs installed in new BlackBerrys will go in its Tour model. Subsequent versions have trackpads, which allow users to manipulate their devices by moving a finger across a pad linked to an optical sensor. By 2013, iSuppli predicts trackball shipments will have ceased altogether. "Dead and gone is good," says Alexandra Hayden, 38. The designer, based in New York, has endured one too many trackball transplants. (BlackBerry maker **Research In Motion** declined to comment for this story.)

Others marvel at the liberation the orb represented in comparison to the earlier sidewheel. "When they went from the sidescroll to the trackball, that was a freeing moment," says Brooke Hammerling, 35, founder of Brew Media Relations in New York. The rolling thumb-mouse is perfect, she explains, for the BlackBerry game BrickBreaker.

The trackball repair business won't fade immediately, according to Naftchi, 47. He's still fixing old side-scroll wheel units years after they ceased production. Diehards will cling to trackballs, too. More than 80 million will have shipped before the curtain comes down, iSuppli projects.

Besides, nothing worth having ever goes away entirely. You can still buy a new manual typewriter on **Amazon.com** for $99.95. Betamax has its determined fans. And **Westfield Whip Manufacturing** in Westfield, Mass., produces more than 50,000 buggy whips annually. It's hard to kill a consumer icon. —*Jeff Green*

The bottom line *Although future BlackBerrys will come with trackpad sensors, some customers will cling to the old technology*

Product Shot

Bang & Olufsen's new BeoLab 11 Tulip is no ordinary subwoofer. It costs $2,000, comes in seven colors, and is made for prominent display, not for hiding under a desk. A bridge near the top keeps the device from shaking like a tuning fork each time it produces a deep rumble. —*Cliff Edwards*



(TOP) JEMAL COUNTESS/GETTY IMAGES

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Call of Duty: The latest edition rang up $550 million in sales in its first five days

Gamers

Did Activision Just Frag Itself?

- ▶ The game giant is in a legal battle with the creators of Call of Duty
- ▶ Fueling the fracas: The "rise and power of the elite developer"

The spat has all the plot points of a classic Hollywood throwdown: stars, studios, dueling lawsuits, secret meetings, and lots of money. Except this one isn't about movies. It's about video games.

On one side is Bobby Kotick, the outspoken CEO of Santa Monica (Calif.)-based **Activision Blizzard.** On the other are two of his erstwhile prized game developers, Vince Zampella and Jason West. Kotick bought their studio, Infinity Ward, for $5 million in 2003. For a while it was a profitable relationship. Zampella and West created the $3 billion-plus Call of Duty series, the seventh-best-selling game franchise ever. The latest edition, Call of Duty: Modern Warfare 2, rang up $550 million in the first five days after its release on Nov. 10.

On Mar. 1, Kotick announced the firing of the two developers. On Mar. 3, West and Zampella sued Activision, accusing the company of "astonishing arrogance and unbridled greed." They said Activision conducted a sham internal investigation about their contact with rivals as an excuse to fire them and avoid making royalty payments on Modern Warfare 2.

A month after their termination, West and Zampella signed a deal with Kotick's Silicon Valley archrival, **Electronic Arts,** the second-largest game publisher after Activision. On Apr. 8, Kotick countersued the duo, accusing his former employees of insubordination, withholding employee bonuses as a way to turn staff against Activision management, and taking a secret trip to Northern California to meet with an unnamed competitor. West, Zampella, and Kotick all declined to comment about the lawsuits.

Charges about secret trips and internal investigations aside, this battle is really over the future of the Call of Duty brand. Lines of fans bought Modern Warfare 2 at its special midnight release. Players have logged more than 1.75 billion hours of gametime—that's 200,000 years—on **Microsoft**'s Xbox Live online system. The success comes at a time when hits are increasingly rare. In 2009, when industry sales declined 10%, Activision earned $113 million on $4.3 billion revenue. That's not bad considering that rivals EA and **Take-Two Interactive Software** lost money.

According to court documents filed by both sides, the once beautifully lucrative relationship began unraveling during the 20 months it took West, Zampella, and their studio to make Modern Warfare 2. West and Zampella said Activision emphasized "quantity over quality." Employees were made to work at a "breakneck pace" to deliver the game in time for its November release. During that period, said Activision in court documents, West and Zampella hatched their plot to leave the company. According to Activision's suit, a rival executive sent the pair an e-mail that read, in part, "glad to have super secret way" to communicate.

Activision, controlled by French conglomerate **Vivendi,** does have other big franchises, most notably World of Warcraft, a $1.23 billion-a-year subscription-based online game that's proved to be the company's most

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Technology

consistent earner. But WoW will soon face competition from a new EA online title, Star Wars: The Old Republic. Another big-money Activision property—the Guitar Hero music franchise—has begun to fade.

Kotick is no stranger to fights. To protect Guitar Hero, which he acquired in 2006, he tussled with the original designer, **Harmonix,** after it signed a deal with **MTV Games** and Electronic Arts to make Rock Band. Activision sued **Double Fine Productions** to stop the release of another music game, Brutal Legend, which starred the actor Jack Black.

The Call of Duty clash is a sign of the "rise and power of the elite developer," says Evan Wilson, an analyst at Pacific Crest Securities. That shift in clout makes the game industry more like films and books, where creators maintain more control over their intellectual property. The creative types are getting greater leverage because of the rising cost of games: The high-def sophistication of the current generation of Xbox 360 and PlayStation 3 consoles has doubled or tripled development costs for publishers such as Activision. Wilson says a complex, graphically rich game must sell more than 2 million copies to turn a profit. "Only those elite developers and elite franchises are profitable," he says.

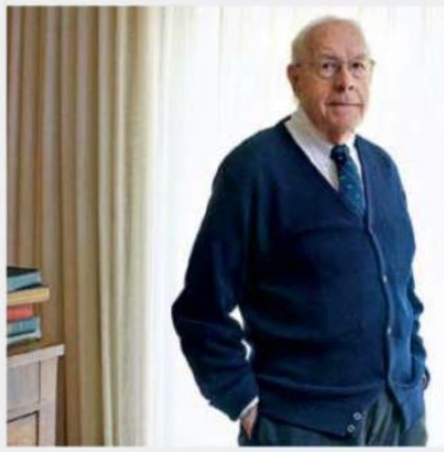
Colin Sebastian, an analyst with Lazard Capital Markets, says the question is whether Kotick will be able to keep product quality as high as it was under West and Zampella so that fickle gamers will buy new Call of Duty versions. "Most gamers probably don't care that much" about who designs what, he says. "What they care about is the quality of the game. And that's why there is a lot of pressure on Activision."

Kotick says 400 to 500 people are working on the Call of Duty franchise and that the departure of two won't impede its success: "It's not about a single individual or one or two guys. Our commitment to quality hasn't changed." He adds that he's stepped up recruiting efforts, too. "If you want to make great games and be handsomely compensated," he says, "then the single best game to work on is Call of Duty."

—Adam Satariano

The bottom line *Losing the talent behind Call of Duty stings Activision. It still has a steady earner in the subscription-game World of Warcraft.*

Innovator
Fred Brooks



The man who changed the way companies produce software has a new book that goes beyond tech, with advice for anyone managing a design team

Some tech visionaries, such as Bill Gates or Larry Ellison, build empires out of the utilitarian. Less common are the Steve Jobs-types, who create stuff people wait overnight in lines to buy. Then there is the very small club of people who made those titans possible. A member in good standing is Frederick P. Brooks Jr., pioneer of modern software.

Brooks, a 79-year-old computer scientist and former IBM executive, wrote an oddly named book 35 years ago called *The Mythical Man-Month* that laid out the organizing principles of how software gets made. "If a computer is a part of your life today," says Bill Buxton, principal scientist at Microsoft Research, "then you've been highly influenced by Fred Brooks and his work."

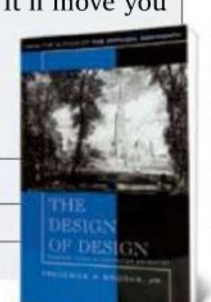
Now Brooks has a new book, *The Design of Design*, in which he takes his message beyond tech. It's a collection of essays that draws on his own adventures as well as conversations with designers of every species.

In the 1950s and '60s, Brooks ran product-development teams at IBM. The company would set budgets for projects based on "man-months." If 25 people required 10 months to write some code, that worked out to 250 man-months. If the project ran late, you just added people. The man-month was a convenient device that was, Brooks wrote, nonsense. Expanding a late-running design team *slowed* the process. It forced veterans to bring newbies up to speed right when they needed to hunker down. "It's a fundamental insight," says Andy van Dam, a professor of computer science at Brown University. "Fred updated that old saying that nine women can't make a baby in one month."

In 1961, IBM had him manage development of a new family of mainframes. About 1,000 people worked on System/360; Brooks insulated his core design team from the usual corporate bureaucracy. Unveiled in 1964, System/360 helped cement Big Blue's position as the world's biggest computer company. *Man-Month,* which documented the project, has sold 500,000 copies. Programmers still refer to Brooks' Law: "Adding manpower to a late project only makes it later."

With the new book, Brooks, now a professor at the University of North Carolina at Chapel Hill, shares more design tales from his IBM days and after. Brooks breaks down projects to assess what went right and wrong each time, and has suggestions for anyone who manages creatives. Sample tip: "Constraints are friends" that "shrink the designer's search space," a notion familiar to anyone who's ever felt paralyzed by open-ended essay questions. Another: Design is as much art as science. "Improving your process won't move you from good to great design," he says. "It'll move you from bad to average." And that's *not* how legends are made. **B**

—Helen Walters



Impact ▶ **Father of the modern software business**

Day Job ▶ **Computer scientist, University of North Carolina**

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Goldman: The Mystique Of Indispensability



Goldman Sachs' new headquarters in Manhattan. The bank's market cap shrank by $12.8 billion on Apr. 16

PHOTOGRAPH BY DAVID S. HOLLOWAY FOR BLOOMBERG BUSINESSWEEK

▶ **Clients are standing by the investment bank even though the SEC says it deceived a customer**

▶ **"There is no firm that can step in and replace them," says bank analyst Richard Bove**

On Apr. 16 the Securities & Exchange Commission sued **Goldman Sachs** for misleading a client about an esoteric investment tied to home mortgages. In denying the allegations, Goldman was defiant, insisting it had told its customer, the German bank **IKB**, all it needed to know. IKB could fend for itself, according to the most profitable Wall Street firm in history.

You might think other Goldman clients would find that stance distressing. Not so. A lot them say they're not going anywhere. "We have had a long relationship with Goldman Sachs and expect it to continue," Mark Truby, a spokesman for **Ford**, tells Bloomberg News. Goldman took Ford public in 1956, and a former Goldman executive, John Thornton, sits on Ford's board.

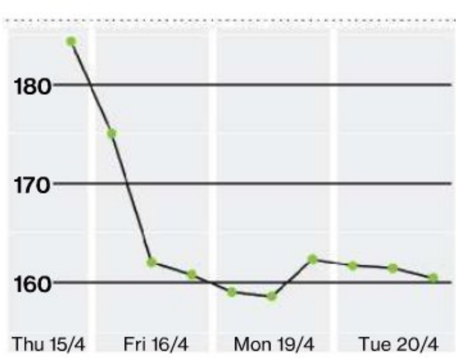
"Everything's business as usual with Goldman," says LuAnn Jenkins, a spokeswoman for **National Semiconductor**. **Macy's** likewise is pleased with the advisory services Goldman provides and doesn't plan any changes, Jim Sluzewski, a spokesman for the retailer said via e-mail. **Rite Aid**, the drug store chain, is standing pat, too. Managers of hedge funds say in interviews that they have no reason to abandon Wall Street's foremost trading firm.

Goldman, naturally, feels gratified. "We have spent an enormous amount of time talking to our clients," David Viniar, the firm's chief financial officer, told reporters on a conference call on Apr. 20. "We found that largely our clients are supportive of us, and the most important thing is to perform."

Goldman announced that first-quarter earnings jumped 91%, to $3.46 billion, surpassing most analysts' expectations. Investors, after dumping shares and knocking $12.8 billion off Goldman's market value on the Friday the SEC filed its suit, have calmed down. On Apr. 21, Goldman stock closed at $158.93 down 1.1% from the Friday closing price.

Depending on what the government and potential piggy-backing private litigants can show, Goldman may yet face client defections, especially in the public sector. German Chancellor Angela Merkel's administration may avoid awarding new business to Goldman if the SEC

Goldman Sachs' Stock Price



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Recent deals both large and strange page 62 ►

allegations are proven, a government official tells Bloomberg.

British Prime Minister Gordon Brown decried the "moral bankruptcy" he perceived in the SEC's claims against Goldman, and the British Financial Services Authority said it will begin a formal investigation. Yet the government wasn't talking about a boycott. "I don't think you can stop doing business with a firm because an individual is accused of doing something," Alistair Darling, the U.K. Chancellor of the Exchequer, said on Apr. 20. The British are disappointed, in other words, in Fabrice "The Fabulous Fab" Tourre, a French banker, 31, who structured and marketed the now-notorious CDO deal for Goldman (see following story). Tourre's employer, at least for now, will retain its relationship with the U.K. government.

The customer loyalty is touching, and perhaps a bit puzzling. Under CEO Lloyd Blankfein, old school investment banking has taken a back seat as profits from risk-juggling trading operations make the firm seem more like a supercharged hedge fund. Goldman's list of business principles still says that "clients' interests always come first." That noble assertion of Wall Street chivalry must inevitably give way when Goldman acts as a broker. The best it can offer is neutrality as it finds someone to buy what you're selling, or vice versa. When you transact with Goldman in its dealer role, it is explicitly on the other side of the trade. Even clients of other parts of the firm must recognize that in such instances they are up against Goldman as adversaries.

Goldman's mystique of indispensability appears likely to survive, according to Richard Bove, an analyst at **Rochdale Securities**. "The argument that Goldman takes positions in opposition to its clients has always been there, yet people continue to do business with Goldman Sachs," Bove said in an interview on Bloomberg TV. "The reason is they aren't playing the clients; they are benefiting the clients. There is no firm that can step in and replace them." One way or the other, the thinking goes, Goldman gets the job done. Not coincidentally, Bove recommends buying Goldman shares.

Recognizing that its unabashed PR strategy might play differently depending on cultural sensitivities, Goldman hasn't offered the "buyer beware" defense in all situations. The firm is telling customers in Japan, for example, that it didn't push the type of CDO there that is at the center of SEC suit. "We are explaining to our clients in Japan that the synthetic CDO in question was not sold in Japan," Hiroko Matsumoto, a Goldman spokeswoman in Tokyo, tells Bloomberg. She won't comment on the responses received from Japanese clients. —*Paul M. Barrett with Matt Townsend and Christine Harper*

The bottom line *For now, at least, many of its customers don't seem troubled by the claims against Goldman.*

Wall Street

The Banker at the Center of the Storm



▶ Fabrice Tourre will testify on the Hill about SEC allegations

▶ "He's a kid ... making $2 million a year. He's easier to intimidate...."

An indiscreet e-mail written by Fabrice Tourre, the banker at the center of the U.S. government's investigation of Goldman Sachs, helped the Securities & Exchange Commission build its case against the investment bank. Now, Tourre, a young French citizen who called himself the "Fabulous Fab" in that e-mail, finds himself at the center of a major showdown between Washington and Wall Street over the financial crisis.

Tourre has agreed to testify at a Senate hearing on Apr. 27, along with Goldman Chief Executive Officer Lloyd Blankfein. What he has to say may offer interesting clues about the early direction of the government's legal case against Goldman. The SEC sued Tourre and Goldman Sachs last week, contending that they did not tell investors in a 2007 collateralized debt obligation that hedge fund Paulson & Co., which planned to bet against the CDO, played a significant role in selecting the underlying mortgage-backed assets.

The SEC likely named Tourre in the lawsuit to put pressure on him to "roll over," says Elizabeth Nowicki, a former SEC lawyer. "They're hoping that he tells the SEC whatever he knows about this case or other fraudulent transactions he might know of," she says. "He's a kid, with a lot of ego, making $2 million a year. He's easier to intimidate than a senior executive."

Tourre, who joined Goldman Sachs in 2001 straight out of Stanford University, worked in the firm's New York-based mortgage securitization trading operation just as the housing market was unraveling. One former employee remembers him as smart, detail-oriented, and "putting in ungodly hours" as he tried to come up with clever ways to create complex securities.

A strand of this story worth watching, attorneys say, will be any sign of Goldman executives distancing the firm from Tourre's actions. "It's all going to be a factual dispute about what he remembers and what the other folks remember on the other side," Greg Palm, Goldman's co-general counsel, said in an Apr. 20 call with reporters, without naming Tourre. The Wall Street bank has denied wrongdoing and said it will fight the SEC's case because it's "completely unfounded in law and fact." Pamela Chepiga, Tourre's lawyer at **Allen & Overy** in New York, didn't return two calls seeking comment. Tourre, who also couldn't be reached, likely will seek to defend his conduct before the Senate permanent subcommittee on investigations, say two people briefed on his appearance.

Goldman placed Tourre, now an executive director based in London, on indefinite paid leave and de-registered him with the U.K.'s Financial Services Authority. The bank hasn't publicly suggested that he acted wrongly. In the Apr. 20 call, Palm said that "if we had evidence that someone here was trying to mislead someone, that's not something we'd condone at all, and we'd be the first one to take action." Nowicki sees that statement as keeping the door open to a "rogue trader" defense. Charles Whitehead, a law professor at Cornell University, thinks

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Goldman's even-handed treatment of Tourre so far would make that tough: "They're clearly saying that they haven't found anything on Tourre themselves. Otherwise, they would have punished him earlier."

Government investigators obtained an e-mail from January 2007 in which he wrote: "The whole building is about to collapse anytime now." Tourre also wrote that the "only potential survivor, the Fabulous Fab ... standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstruosities!!!"

The SEC will need much more than an e-mail to win its case against Tourre or implicate other, more senior, Goldman executives. Based on its response so far, the investment bank does not seem worried, says Nowicki: "Goldman is as overly confident as one would have thought."
—*Yalman Onaran and Gavin Finch*

The bottom line *Much is riding on whether the SEC's case against Goldman Sachs ends with Fabrice Tourre or just begins with him.*

Corporate Debt

Knocking Down The 'Maturity Wall'



▶ Investors seeking higher yields are helping companies refinance

▶ "Market conditions have clearly eased"

In the credit markets, it's called the "maturity wall"–the $1.2 trillion of corporate debt that will have to be paid off or refinanced over the next five years. The worry is that with bank lending at about a quarter of its pre-crisis levels, there will be a second wave of corporate debt defaults to rival

➜

ILLUSTRATION BY GREG MABLY; PHOTOGRAPH BY AXEL GRIESCH/ASFM/GETTY IMAGES

The Financial Life

Edouard Carmignac



A bold move into stocks last year has made the veteran French fund manager a star

On Sunday Mar. 8, 2009, fund manager **Edouard Carmignac** was wandering in a rice paddy near Chiang Mai, Thailand, doing some sightseeing after two weeks visiting companies in Asia. Equity markets around the world had tumbled to their lowest point in 13 years. "Markets were in absolute despair," Carmignac, 62, says. "The weekend newspapers were predicting the end of stocks. It was too good to be true."

In the following days, his Paris-based firm, **Carmignac Gestion**, poured more than $6.8 billion into stocks, the maximum it could invest under its charter. The timing was perfect: The market rebound started that very Monday. **Carmignac Investissement**, his $9.3 billion all-equity fund, posted a 42.6% return for 2009, vs. 27.4% for the MSCI AC World Index. The firm's biggest fund, the $26.7 billion **Carmignac Patrimoine**, which mixes stocks and bonds and avoided a loss in 2008, notched a 17.6% gain in 2009, vs. 13.4% for its Morningstar benchmark.

Those spectacular numbers have made Carmignac a money magnet. Last year, Patrimoine drew $14.2 billion from investors, more than any fund except Bill Gross' **PIMCO Total Return**, according to fund researcher Strategic Insight. Overall, Carmignac Gestion tripled its assets under management, to $54 billion, and expects to reach $68 billion this year. "It takes balls and brains to be good at this job," Carmignac says, reflecting on the move that paid off so richly.

Paintings by Roy Lichtenstein, Keith Haring, Jean-Michel Basquiat, and others decorate the walls of Carmignac's office, which is on the Place Vendôme in Paris, between jewelers Van Cleef & Arpels and Boucheron. "The world has always been my natural playground," says Carmignac, who as a child lived in Peru and got his MBA at Columbia University. "Of course, if we don't understand [an investment], we stay away."

Carmignac, who still owns about 70% of the firm he founded in 1989, has long followed a "top-down" investment strategy. He looks for sustained economic trends, then makes concentrated bets on sectors and companies that stand to benefit from them. He also uses derivatives such as options on indexes to hedge portfolios in difficult times and change gears quickly in rebounds–as he did last year.

Today, more than half the firm's money is in emerging-markets stocks and commodities; recent purchases include **China Construction Bank** and **All América Latina Logística**, Brazil's biggest railroad operator. The rest is mostly invested in U.S. stocks, including **Freeport McMoRan Copper & Gold** and **MasterCard**, a play on the economic revival.

Carmignac looks up at the giant Warhol portraits of Lenin and Mao hanging on either side of his desk. "They are here to remind me," he says, "never to take anything for granted." **B**
—*Anne-Sylvaine Chassany*

Company ▶ **Carmignac Gestion** ▶ **Founded in 1989**

Main funds (assets) ▶ **Patrimoine ($26.7 billion)** ▶ **Investissement ($9.3 billion)**

Five-year cumulative return ▶ **Patrimoine: 60.2%** ▶ **Investissement 90.2%**

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last year's record $628 billion.

Over the past 15 months, though, the wall has been getting less fearsome. One reason: Investors have been pouring cash into mutual funds that invest in risky debt, making more money available to companies that want to refinance debt. "Chipping away is an understatement," says Martin Fridson, chief executive of New York-based money manager **Fridson Investment Advisors.** Junk-bond sales are "really mitigating that wall of maturity risk."

Since the beginning of last year, borrowers have been able to cut the amount of high-yield loans and bonds coming due in the next five years by $196 billion, according to **JPMorgan Chase**. In one recent offering, **Cablevision Systems,** the New York area cable TV provider, sold $1.25 billion of bonds in mid-April, using the proceeds to refinance.

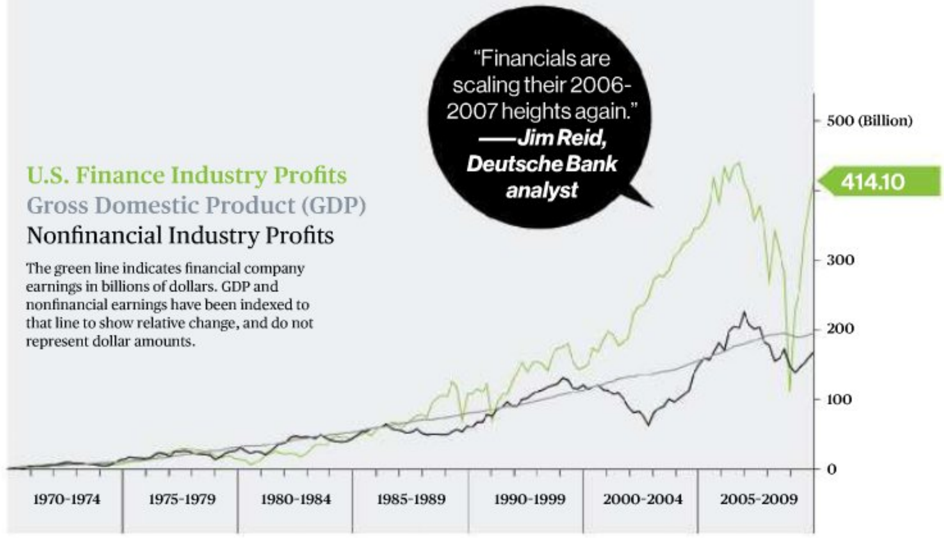
Improvement in the credit markets can go only so far, though. To get past the maturity wall, companies will need the help of a prosperous economy. "Market conditions have clearly eased," says Diane Vazza, head of **Standard & Poor's** global fixed-income research. But "companies that have these maturities in 2012, 2013, and 2014, they still need to generate top-line growth."
—John Detrixhe and Emre Peker

The bottom line *With super-safe instruments like Treasuries and CDs paying tiny yields, investors are taking risks to get better returns.*

Profits

Banks Are On the Rebound

Even before Citigroup and other financial companies began reporting strong earnings for the first quarter, banks' profits were again growing faster than those of other corporations.



Sovereign Debt

Back on the Market: Russian Bonds

▸ Moscow tests the waters for the first time since 1998

▸ Rising oil prices have lifted the economy out of recession

Moscow is returning to the credit markets for the first time since the economic crisis of 1998, when the Russian government devalued its currency and defaulted on debt. Officials including Deputy Finance Minister Dmitry Pankin visited the U.S., Europe, and Asia earlier this month to drum up investor interest in the bonds. The first sale was expected on Apr. 22; the government is seeking to borrow as much as $17.8 billion this year.

The timing is propitious: Thanks in part to a rally in oil, Russia's biggest export, the country's economy is recovering from its worst recession since the collapse of the Soviet Union. The World Bank estimates economic growth will hit 5.5% in 2010. And analysts predict Russian corporate profits will soar this year and next as oil prices continue to climb. Earnings for companies in the Micex Index will rise 97% during the period, as crude climbs to an average of $87 a barrel in 2011 from $82.59 today, based on projections compiled by Bloomberg.

The biggest beneficiaries of the debt sales may be Russian markets, as Moscow's ability to raise funds boosts confidence. Says Liam Halligan, chief economist at Prosperity Capital Management, which has $4.2 billion invested in Russia: The sales "could lead to the beginning of a reappraisal across a whole variety of Russian asset classes through corporate bonds and into equities."
—Denis Maternovsky and Michael Patterson

The bottom line *In the wake of the government's debt sales, Russian companies may find it easier to attract buyers for their stocks and bonds.*

Futures

CFTC Green-Lights a Film Derivatives Market



▸ Hollywood and Capitol Hill give the idea two thumbs down

▸ "Creating perverse incentives for movie failure"

Financial innovation is far from dead. Two companies, **Cantor Fitzgerald** and **Media Derivatives,** are planning rival futures markets for speculating on movie box-office returns. The U.S. Commodity Futures Trading Commission approved the idea on Apr. 16.

LLUSTRATION BY GREG MABLY

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Protection for "good companies" page 65 ▶

The early reviews from Hollywood and Capitol Hill are miserable. Members of the Senate Judiciary Committee warned CFTC Chairman Gary Gensler in an Apr. 15 letter that encouraging such speculation would risk "creating perverse incentives for movie failure that may undermine the integrity of the industry." Senator Blanche Lincoln, an Arkansas Democrat, has included language banning the futures in a broader derivatives bill approved by the Senate Agriculture Committee on Apr. 22.

The film industry would hate the idea, says Peter Guber, CEO of the independent production company **Mandalay Pictures.** Promoters of film futures suggest that entertainment financiers might want to hedge their investments in a movie by betting some money that it will fail. No way, says Guber: "The word will get out in three seconds, and the picture will be a complete catastrophe." The media would focus on the financiers' doubts; word-of-mouth would turn poisonous.

For cinematic futures to get off the ground, the CFTC would have to provide additional approvals for the details of the new trading operations. That further permission is far from assured, warns Commissioner Bart Chilton. Final clearance of what he calls a "popcorn prediction market" would be "a very different question" from allowing the bare-bones notion of the exchanges to move ahead, Chilton says via e-mail. He told Bloomberg TV before the CFTC vote that he was "worried about manipulation."

The financial services firm Cantor Fitzgerald already owns Hollywood Stock Exchange, a Web site where fans use imaginary currency to bet on movies. Media Derivatives has said that its first real-money film futures will focus on opening-weekend box office. The company plans to begin trading in the third quarter of 2010, according to spokeswoman Stephanie DiIorio.

Media Derivatives CEO Robert Swagger predicts that movie futures would "help better manage economic uncertainty and financial volatility." In a filing, the company added that trading would hedge risks related to calamities ranging from terrorism to "climate events such as severe snow storms."
—*Todd Shields and Michael White*

The bottom line *Hollywood insiders and some senators worry that movie derivatives could influence which films bomb at the box office.*

ILLUSTRATION BY JENNIFER DANIEL; PHOTOGRAPH BY ERIC RYAN/GETTY IMAGES



Permira's purchase of Valentino appears to be a misstep. Recouping the $7.2 billion it spent will be a struggle

Deals

Private Equity's Fashion Hits and Misses

- **A rich deal may whet buyout firms' appetite for luxury**
- **"There's a creative and soft aspect ... that's not really controllable"**

Private equity and fashion are a bad combo, kind of like pairing a Dior dress with Ugg boots. That at least was the established wisdom until March, when **Apax Partners** sold **Tommy Hilfiger** for $3 billion, quintupling its investment in the American clothier in just four years. The rich payoff may inspire other investment firms to sharpen their fashion sense.

There's no shortage of potential acquisition targets. A $22.8 billion drop in worldwide luxury spending since 2007 has left players such as fashion house **Gianfranco Ferré** and suitmaker **Brioni Roman Style** cash-starved. Buyout firms have more than $500 billion to spend. "There are many companies that have ownership problems, execution problems, family-driven issues, succession issues, all triggers for transactions," says Christian Stahl, a partner at Apax.

Still, it may take more than the Apax deal to erase the memory of some big disappointments. Among the most high-profile stumbles is **Permira Advisers**' acquisition of the **Valentino Fashion Group,** which encompasses the haute couture house whose gowns are perennial red-carpet staples as well as German label **Hugo Boss.** In 2007, at the peak of the buyout boom, London-based Permira paid $7.2 billion for Valentino, money it may have trouble recouping. The departure of founder Valentino Garavani, the recession, and the nearly $3 billion in debt Permira piled on have hurt profitability. The buyout fund's largest backer, **SVG Capital,** has written down its initial investment by 53%. Valentino's owners have also had to inject an additional $336 million into the company.

Permira's struggles are instructive. Private equity's heavy use of debt to finance deals is especially ill-suited to a business where revenue streams are unpredictable and subject to what's known as fashion risk. Sharp managers can work to improve cash flow, trim production costs, and overhaul distribution, but that may not be enough. "There's a creative and soft aspect to the industry that's not really controllable," says Stahl. "It's not a manufacturing business, and some people have paid a high price for not being mindful of that."

Then there's the time factor. Private equity's preferred three- to five-year investment period usually isn't long enough "to reposition or develop a brand," says Mario Boselli, president of the **National Chamber of Italian Fashion. Texas Pacific Group**, for instance, spent nine years buffing Swiss shoemaker **Bally International** before selling it in 2008.

Perhaps the biggest obstacle to successful deals is the fact that many family-run businesses are unwilling to cede control to financial investors. Private equity accounted for less than 20% of all mergers and acquisitions in fashion in 2009, down from 27% in 2007. In Italy, the luxury houses

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Prada, Giorgio Armani, and **Roberto Cavalli** have all spurned overtures from buyout firms in recent years. "Apax hit the jackpot," says Alessio Candi of the Milan-based luxury consulting firm **Pambianco.** "But attractive targets, which would consider opening their capital to fund growth, are hard to find." *—Andrew Roberts and Anne-Sylvaine Chassany*

The bottom line *Finding the next Hilfiger won't be easy in a business that is subject to consumer trends and not always welcoming to financial buyers.*

The Bailout

A Fund Manager Sees Gains Ahead for AIG

- Fairholme Capital is now the insurer's No. 2 investor
- "The government is going to make good money"

Who owns **American International Group**? We do! U.S. taxpayers, that is. The federal government has an 80% stake in the bailed-out insurer. And at least one shrewd investor thinks we're on to a good thing. **Fairholme Capital Management,** the investment firm run by Bruce R. Berkowitz—named domestic stock fund manager of the decade by **Morningstar** in January—has acquired about 15 million AIG shares, second only to Uncle Sam.

Fairholme started building the stake in the second half of 2009 "as we started to see cash flows of AIG turn positive," Berkowitz says. His firm's shares are valued at about $625 million based on the Apr. 20 closing price of $41.63. The stock has gained almost 40% this year as Chief Executive Robert H. Benmosche struck deals to sell two life insurance units for about $51 billion to help repay the government. Washington's aid package ultimately swelled to $182.3 billion.

Berkowitz says that Fairholme has also invested in the debt of AIG. "It is still a good company with a good global brand," he says. "The government is going to make good money on AIG." *—David Henry and Hugh Son*

The bottom line *Bruce Berkowitz is betting on CEO Robert Benmosche's leadership and the power and global reach of AIG's brand.*

Bid & Ask

Retailing

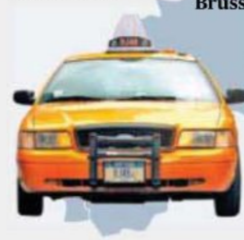
Japan's Fast Retailing set a Manhattan record when it signed a **$300 million,** 15-year lease on a 90,000 sq. ft. space at 666 Fifth Avenue. It will be home to the world's biggest Uniqlo store



Travel

Comedian John Cleese paid **$5,100** for a 935-mile cab ride from Oslo to Brussels after his flight out of Norway was grounded by volcanic ash





Emerging markets

Argentina unveiled a plan to swap $20 billion in defaulted government bonds for new securities, offering investors **33.7¢** on the dollar



Entertainment

Movie moguls Bob and Harvey Weinstein have offered **$625 million** to buy back Miramax Films from Walt Disney



Banking

$3.8 bn

Amount Toronto-Dominion Bank spent to buy three failed Florida-based lenders. Canada's No. 2 bank has about 1,000 branches in the U.S.

Confectionery

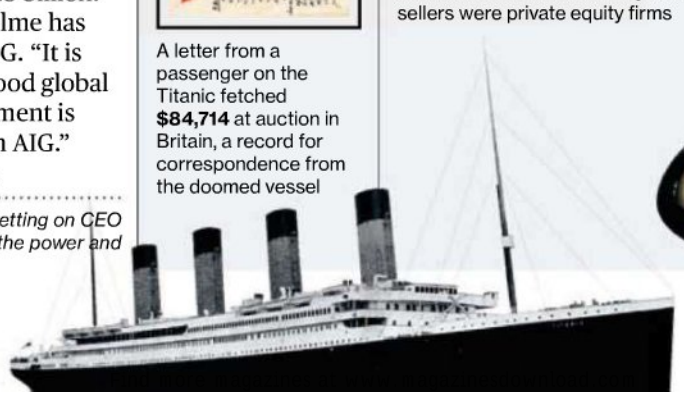


Former Cadbury Chief Executive Todd Stitzer walked away with more than **$35 million** after selling the candymaker to Kraft Foods

Collectibles



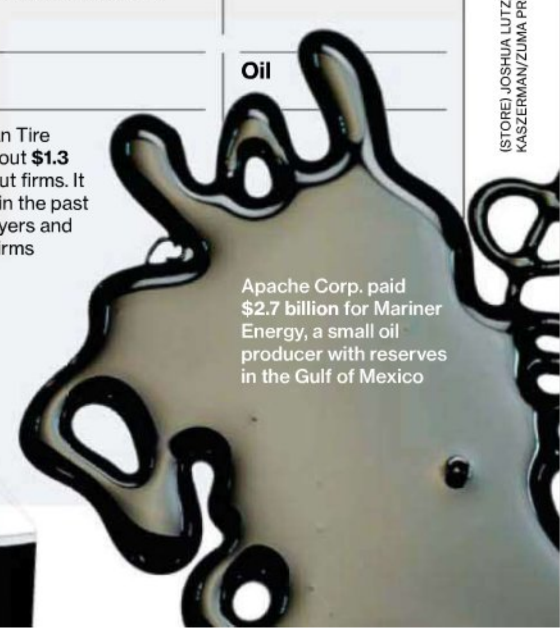
A letter from a passenger on the Titanic fetched **$84,714** at auction in Britain, a record for correspondence from the doomed vessel



Buyouts

TPG agreed to buy American Tire Distributors Holdings for about **$1.3 billion** from a group of buyout firms. It was at least the fourth deal in the past two weeks in which both buyers and sellers were private equity firms

Oil



Apache Corp. paid **$2.7 billion** for Mariner Energy, a small oil producer with reserves in the Gulf of Mexico

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Focus On **Enterprise**

The Ben & Jerry's Law: Principles Before Profit



ILLUSTRATION BY JENNIFER DANIEL

▶ New legal protections for companies committed to social good

▶ Maryland is the first state to create "benefit corporations"

When Ben Cohen and Jerry Greenfield sold **Ben & Jerry's** to **Unilever** for $326 million a decade ago, they did so reluctantly. They liked the payout but feared the new owners would ignore the social goals famously embraced by the ice cream maker. The board, though, felt it had no choice but to accept Unilever's offer. "The legal advice was that the primary concern for the directors was the financial interests of the shareholders," says Greenfield.

Entrepreneurs who want to put principles before profits—even after their companies go public—may soon have the legal cover to do just that. On Apr. 13, Maryland Governor Martin O'Malley signed a law creating legal entities known as "benefit corporations" and giving them greater protection from shareholder lawsuits. California and Vermont have similar bills in the works and legislators in at least three other states, including New York, are considering them. While many entrepreneurs applaud the measures, corporate governance experts worry about the rights of shareholders.

Interest in so-called socially responsible businesses by investors and entrepreneurs has grown in recent years. More than $2.7 trillion—about 11% of all assets under professional management—were in some kind of socially responsible investment in 2007, the latest data from Bloomberg show. More than 30,000 U.S. companies are members of socially responsible or sustainable business organizations, according to **B Lab,** a Berwyn (Pa.) nonprofit that certifies businesses as socially responsible.

Will shareholders buy in? Most "invest for the return to them, not ... to somebody else," says one lawyer

Under the new Maryland law, benefit corporations must spell out their values in their charters, report annually on activities that benefit the public, and submit to third-party auditing of their societal impact. Becoming a benefit corporation, or shedding that status, would require approval of two-thirds of shareholders.

A California bill would have similar provisions for what it calls "flexible-purpose corporations." In Vermont, a bill creating benefit corporations passed in the state senate and is awaiting action by the lower house. Such measures would "better insulate [companies] from the pressures of short-termism that dominate the public equity markets," says Jay Coen Gilbert, co-founder of B Lab, which has certified 296 companies as B Corporations.

Many more privately held companies are likely to seek benefit corporation status. **Small Dog Electronics** is a 40-employee **Apple** reseller with two stores in Vermont and annual sales of $20 million. CEO Don Mayer wants to recharter as a benefit corporation if the Vermont law is passed, in part because he is considering selling a stake in the company to raise funds for a third store. Small Dog, which is 15 years old, operates e-waste drives that recycle hundreds of tons of discarded electronics. It also matches customer donations to charities and pays 90% of its workers' health premiums. It even covers some veterinary care. "This will

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give us another tool in our quiver to attract the kind of investors that we want," says Mayer, 61, who hopes to ensure that future owners will preserve the company's mission after he retires.

Will shareholders want to invest in companies that don't have a laser-like focus on profit? "Most shareholders invest for the return to them, not for the return to somebody else," says James J. Hanks Jr., a corporate lawyer at Venable in Baltimore. Others think managers could cite these alternative aims as justification for bad decision-making. "If your goal as a corporation is to better the environment, then you should be working philanthropically," says Charles Elson, director of a corporate governance program at the University of Delaware.

That's not the view of Jeffrey Hollender, co-founder of **Seventh Generation**, a $150 million maker of environment-friendly household products based in Burlington, Vt. Hollender took Seventh Generation private in 2000 after seven years as a public company and recently wrote environmental values into his corporate charter. When the company was public, "brokers promoted the stock on primarily financial metrics: Buy this stock and get rich quick," he says.

Hollender, 55, says Seventh Generation's board will consider incorporating as a benefit corporation if the Vermont law passes. He calls the bill "part of a larger transition to a more just, equitable, and sustainable economy. It's the beginning of creating institutions that support that transition." —*John Tozzi*

The bottom line *Activists like the idea of protections for companies with social aims, but corporate governance experts worry about shareholder value.*



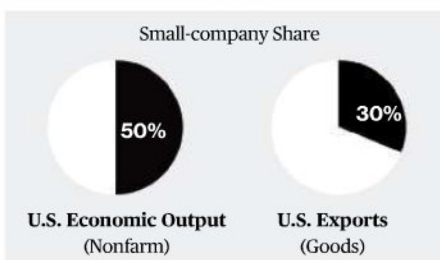
"Selling to Chicago, you know what the laws are," says Ex-Im boss Hochberg. Overseas, "things aren't as clear"

Trade

Why Small Biz is Wary Of Selling Abroad

▶ Entrepreneurs' fears could threaten the success of an export push

▶ Small companies "just don't know how to find customers" overseas



Old Wood, a 15-employee flooring company in Las Vegas, N.M., is just the kind of business President Obama is counting on to help double American exports by 2015. Last month, Obama said he planned to help "firms—especially small businesses—overcome the hurdles to entering new markets." His Administration asked the Export-Import Bank to increase export financing for small business by more than a third, to $6 billion, this year.

Still, it may take more than that to entice many small companies abroad, as the experience of Old Wood demonstrates. In 2008 a theater in Seoul ordered 18,300 square feet of Douglas fir flooring, a job worth $130,000, roughly 10% of the company's revenues. Owner David Old says the buyer passed a credit check, paid a deposit, and made two payments on time. Old delivered the wood, but the final payment of $40,000 never arrived. "I don't think the guy was a crook," Old says. "I think the global economic collapse probably bankrupted him."

Large business dominates exports: The top 500 U.S. exporters accounted for 60% of the $1.2 trillion in exported goods in 2007, the latest period for which such figures are available. Companies with fewer than 500 employees account for half of private nonfarm U.S. economic output but only 30% of exported goods, according to the Small Business Administration and the Census. American products "are in great demand all around the world, but U.S. companies just don't know how to find customers," says Commerce Secretary Gary Locke, "especially small and medium-size companies."

Federal assistance would go a long way toward fixing that, says Tomas Hult, director of the International Business Center at Michigan State University. "If there's some

→ 70

Unsolicited Advice

Caterina Fake, co-founder of Hunch.com

"After Yahoo acquired Flickr, it would have been easy for me to build another social networking or photo-sharing site. But I'm doing something different with Hunch, taking risks. I was offered gigs that would have meant much more money and security. I'm a single mom, so I could easily have justified a less risky venture. You can rest on your laurels or you can start again and have no idea what the hell you're doing—which is obviously much more interesting."



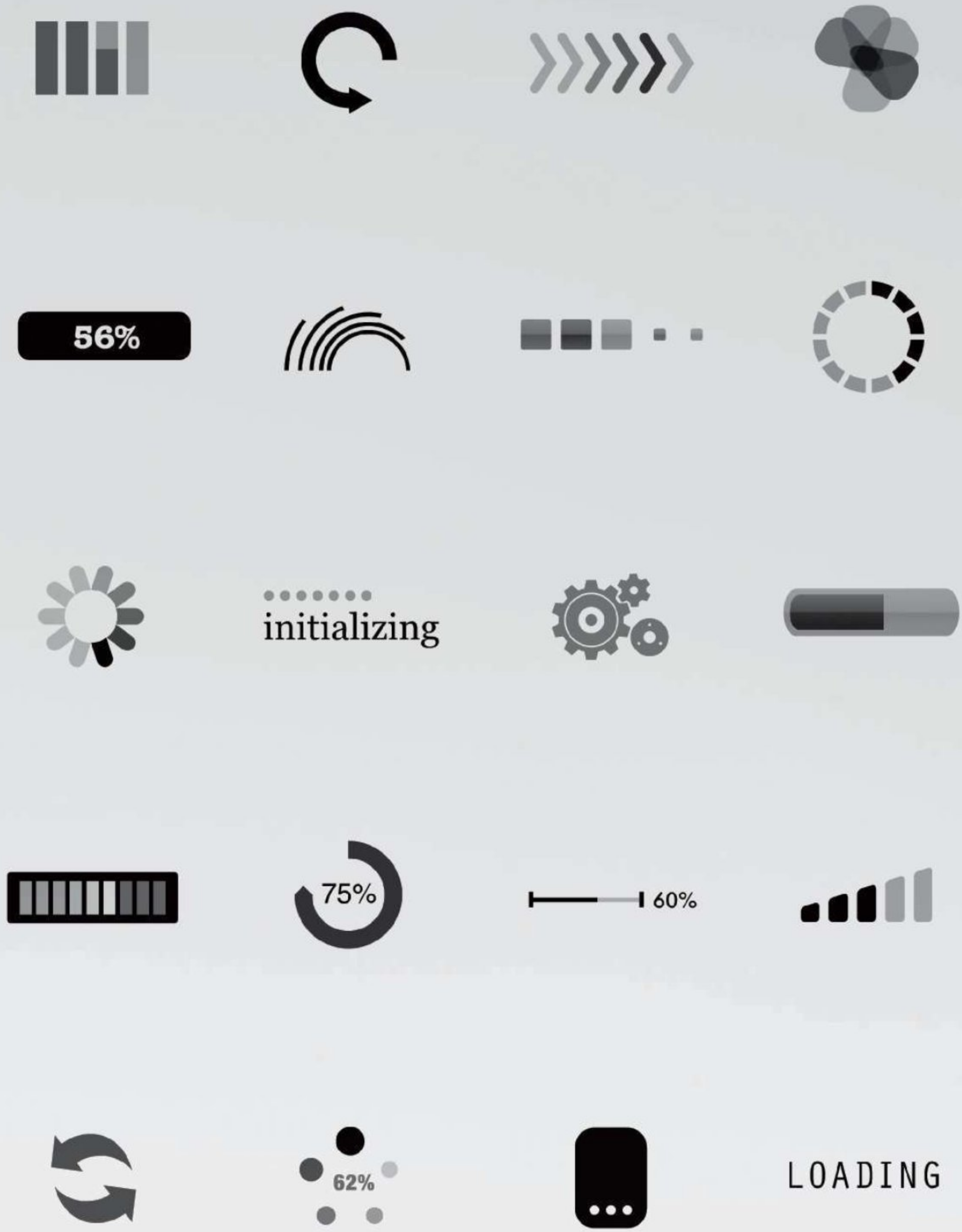
Ex-Flickr boss Fake has moved on to Hunch, a consumer-advice search engine

ILLUSTRATION BY PETER FIELD 1. SMALL BUSINESS ADMINISTRATION AND THE CENSUS.

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Speed Dial

Bankers to the 'Missing Middle'

In 2005, longtime bankers Tim Ferguson (left) and Ron Walker created Next Street Financial, a bank offering financing and advice to inner-city companies

Why did you start Next Street?
Ferguson: There was a significant gap between what traditional financial services providers do and what small businesses in inner cities need: access to growth capital and high-quality advice.

You serve the domestic "missing middle," as you call it.
Ferguson: The marketplace that needs most help is companies with revenues between $5 million and $60 million. There is a lot of focus on startups and on companies with sales under $2 million. But the whole middle area is not getting what they need.

You've said the businesses you're targeting need more than just loans, and that what's truly important is long-term investment.
Walker: The real issue is growth capital. If you have a commercial laundry that obtains a $2 million contract with a hospital, they will now have to perform that work, hire more employees, maybe buy more laundry machines. They will go to the bank, and the bank will focus on their past three years of performance, which will not include the new $2 million contract, so they won't be able to get additional capital to secure that contract. That forces the company to make bad decisions, such as using an existing line of credit to purchase machinery. They actually should be using that for operations, and find a loan to buy the new equipment.

What do you tell clients who are evaluating equity vs. debt?
Ferguson: One of the misperceptions is that the only solution for growth capital is equity. Most owners don't want to give up ownership in their companies. What people don't realize is there are many other sources of capital. If they're classified in Massachusetts as a "light manufacturing" company (the definition is broad—a catering company would fit), they're eligible for something called industrial revenue bonds which let them finance land, a building, or equipment. **B**
—Nick Leiber



Focus On Enterprise

hand-holding ... we're going to see some results," Hult says.

Skeptics counter that government programs will have little effect because export growth is largely dependent on foreign economic expansion and the value of the dollar. Plus, federal policy won't necessarily assuage the fears of small businesses about the difficulties of selling their products abroad. "They look at it as a big risk, and that big risk always has to do with getting paid," says Laurel Delaney, president of GlobeTrade.com, a Chicago-based consultant to small businesses.

Payment isn't the only challenge. Betsy Shields, founder of **Breakaway Technologies** based in Park City, Ill., sells used computer equipment abroad. Exports made up about 30% of her total sales of $2.4 million last year. Brisk business in Hong Kong and Singapore, though, dried up in 2007, when computer hardware manufacturers "dumped a lot of brand new product over there at pretty low prices," she says. A recent prospect in Tanzania looked promising, but tariffs made Shields' goods too costly.

60%
Large-company share of America's total goods exports (2007)

It's also tough for small companies to navigate the different rules away from home. "If you're a small business in New York and you're selling to Chicago, you know what the laws are, you know where the banks are," says Ex-Im Bank Chairman Fred P. Hochberg. "When you're selling overseas, those things aren't as clear."

Still, Old, who speaks six languages (though not Korean), says he is continuing to pursue his global ambitions. He is counting on foreign sales to expand his business from $1.25 million in revenues this year to $20 million by 2013. Old, 54, says he has a good sales prospect in Israel and is learning Urdu so he can speak to another possible customer in Pakistan. "The ability to access international markets via a simple thing called a container is huge," he says. *—John Tozzi*

The bottom line: *The White House wants to increase exports by small business, but entrepreneurs are wary of the unpredictability of global markets.*

PHOTOGRAPH BY MIKE McGREGOR FOR BLOOMBERG BUSINESSWEEK

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COMCAST BUSINESS CLASS

LESSONS LEARNED

Product or service extensions

Expanding a company's target or geographic market is one way to increase sales – adding relevant products or services is another, often more profitable, approach.

Identify the Potential

Selling new products and services to an existing customer base is the most efficient and effective way to boost a business's revenue and profitability. The key is to first identify which products and services your clientele is most likely to buy. It is easy to simply stock more merchandise or promote new service offerings, but unless your customers are interested in purchasing them - from you - you run the risk of wasting time and money and annoying them.



Explore Client Needs

Rather than proactively promoting a wide range of information technology services, Steve Burgess, president of Burgess Consulting and Forensics (www.burgessforensics.com) in Santa Maria and San Francisco, Calif., takes a more reactive route. He waits until an increasing number of customers ask for a specific service before officially offering it.

What started as a floppy drive repair business that his father founded in the 1980s morphed into a commercial data recovery business as Burgess's computer shop clients asked for help finding lost information on computer hard drives. Then attorneys began turning to Burgess to uncover electronic data people purposely tried to destroy, a niche called computer forensics in which Burgess now specializes.

"Look where the market is headed and listen to what clients are asking for."

Burgess's strategy for expansion is to "look where the market is headed and listen to what clients are asking for." Right now he is seeing an uptick in requests from attorneys for e-discovery services, or putting electronic documents into a usable form. Smartphone and pda (personal digital assistant) forensics is also on the rise, says Burgess, who is in the process of developing an iPhone and iPad app of expert witnesses – a tool he knows his clients want.

Don't Get Distracted

Kinga Kerr's high end retail bead store in Newton, Mass., Bead and Pearl (www.beadandpearl.com), has grown 30 percent in the last year due to smart product line and service extensions. Having learned from an unprofitable foray into upscale home décor items not right for her jewelry-focused clients, Kerr recognizes the importance of sticking with what her clients want. "Expanding too far from your core [requires] a whole new customer base," she explains; "it's a whole new business." And if your intention is to build your current business, complementary products and services are where the money is.

Stay with Your Core

Bead and Pearl's customers want beads, semi-precious stones and crystals for jewelry. But in addition to simply selling sophisticated jewelry supplies, Kerr offers popular jewelry-making classes; customers come from several states away to participate. However, some want more hand-holding, so Kerr now provides 45-minute private classes and custom jewelry design. Vintage jewelry restoration is another service Kerr added in response to customer demand.

More recent service extensions at Bead and Pearl have included jewelry kits that customers can buy and complete in an evening at the store. She is now in the process of expanding the store's geographic target market via its Web site,offering online classes and video tutorials, for people out of the area who want step-by-step instructions on how to create their own jewelry.

"Don't get distracted by straying too far from your core business," she advises.

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Taxes

The IRS Targets Permalancers

▸ Small companies are likely to see the greatest scrutiny

▸ "It's easier and quicker to audit smaller businesses"

For decades the IRS has played a game of find-the-freelancer at businesses where independent contractors remain on the payroll for months or even years. Companies, especially small ones, increasingly rely on such workers because they offer greater flexibility—and because they're cheaper. Employers can save as much as 30% on wages by avoiding payroll taxes, unemployment insurance, worker's compensation coverage, and benefits they provide regular employees.

Now both the IRS and state agencies across the country are redoubling efforts to uncover long-term "temps." In February the IRS launched a three-year program that will examine 6,000 companies to find permanent workers misclassified as freelancers in violation of the Tax Code. President Obama's proposed 2011 budget includes funding for 100 additional federal staffers to pursue such cases, and it would repeal a 32-year-old rule allowing companies in industries ranging from construction to health care to legally classify long-term employees as independent contractors. What's more, a 2008 initiative linking the computer systems of various agencies makes it easier for the IRS and states to share data on how companies classify employees.

Most of the IRS action on independent-contractor violations will target small businesses and the self-employed, the General Accountability Office reports. Over the past decade the average size of small businesses has fallen, an indication that they're using more freelancers. In tough economic times, keeping independent contractors on the payroll makes sense because they're easier to shed if the business starts to falter. Furthermore, without the legions of lawyers and tax consultants available to big corporations, small companies are less likely to understand—and therefore to follow—the complex rules covering freelancers.

Quoted

"Entrepreneurs do more than anyone thinks possible. With less than anyone thinks possible."
—Venture capitalist John Doerr, writing on TechCrunch



The moves come amid what some researchers say is closer overall scrutiny of small and midsize businesses by the IRS. Over the past five years the agency has increased by 30% the hours spent auditing companies with less than $10 million in assets while decreasing by a third the time spent on large-company audits, according to the Transactional Records Access Clearinghouse, a research center at Syracuse University. While the IRS disputes that study's methodology and says it isn't targeting small business, some tax experts say such a strategy would make sense. The IRS believes smaller businesses are more likely to evade taxes, says Dean A. Zerbe, a managing director of alliantgroup, a Houston tax consultancy. "It's also easier and quicker to audit smaller businesses."

When small companies are scrutinized by the IRS or other agencies, they have a hard time mounting a challenge to any penalties they might face. Last June, Paula Routly, co-owner of *Seven Days*, an alternative weekly in Burlington, Vt., got a $317 bill from the Vermont Labor Dept. The agency said she hadn't paid unemployment insurance for one of the paper's 14 freelance delivery drivers. Though Routly insists she didn't break any rules and is appealing the assessment, her attorney told her "it might be cheaper to give in than to pay the legal fees it would cost to fight," she says.

The current push could lead federal agencies to standardize the employee classification system so it's clear-

The Health-Care Bill

What to Expect When You're Expecting Reform

The health-care reform law, all 2,400-plus pages of it, won't be fully implemented until 2018. While some self-employed people and small employers won't see any effects for a few years, others will feel the impact almost immediately. Here are some milestones entrepreneurs will want to watch. — *Karen E. Klein*

2010

Businesses that pay more than half of employees' health benefits and have fewer than **26** employees and average annual wages of less than **$50,000** can claim a tax credit of up to **35%** of the cost of premiums.

Self-employed people with medical conditions will be able to buy insurance at reduced rates, and this fall insurers will no longer be able to put lifetime limits on coverage.

2011

Companies with fewer than **100** employees will be eligible for grants to set up wellness programs. Employers can offer bonuses of up to **30%** of the cost of insurance to workers in those programs.

Employers will be required to disclose the value of health-care benefits on workers' **W-2 forms**. Starting in 2018, employees with the most expensive plans will pay taxes on those benefits.

2013

The wealthy will see Medicare taxes rise to **2.35%** (from 1.45%) on earnings over **$200,000** for individuals and **$250,000** for married couples. Tax-exempt contributions to flexible spending accounts for medical expenses will be limited to **$2,500** per year.

Employers' tax deductions for the cost of retirees' Medicare drug benefits will be eliminated.

2014

All citizens and legal residents must have insurance, and individuals and small businesses with up to **100** employees will be able to shop for coverage in new health exchanges. Insurers will be barred from rejecting people with preexisting conditions.

Companies with **50-plus** employees that don't offer insurance could face penalties of **$2,000** per uncovered worker.

DATA: CENSUS BUREAU, CONGRESSIONAL BUDGET OFFICE, IRS, AND HENRY J. KAISER FAMILY FOUNDATION

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Top 10 Cities for Startups

Silicon Heartland

Boulder, Bend, or Boca Raton? ZoomProspector.com, a business location Web site, says smaller cities have become the best places to start new companies. ZoomProspector weighed 11 factors–including the number of startups, quality of the workforce, and resources like universities and venture capital–to compile a list of the top places to build the next Apple or Google. —*John Tozzi*



1. Boulder, Colo.

Long a destination for the outdoorsy, Boulder has become a hub for tech startups, with the University of Colorado and national research labs attracting talent and funding.

Vivek Wadhwa on Boulder: page 78

3. Santa Monica, Calif.

Technology and digital media companies rival the film industry in this small city, a sliver of beach and boardwalk carved out of Los Angeles

5. Irvine, Calif.

About 40 miles outside L.A., Irvine boasts an educated, international workforce, a University of California campus, and abundant space in office parks

7. Bellevue, Wash.

Nestled between Microsoft's home of Redmond and Lake Washington, Bellevue attracts tech talent and has the most patents per capita of the top 10 cities

9. San Francisco, Calif.

The Bay Area's combination of universities, venture capital, and long-established tech giants make San Francisco a prime destination for startups

Population	98,100	73,800	85,100	80,900	184,400	101,500	115,700	52,300	800,100	56,900
Patents per 10,000 pop.	22.3	15.0	8.0	4.3	19.0	21.0	32.0	2.3	9.7	16.2
Creative professionals	29.3%	14.2%	28.8%	13.5%	25.9%	40.1%	26.4%	15.1%	20.8%	26.2%
Education: BA or higher	69.1%	47.3%	55.7%	33.7%	62.2%	69.0%	56.7%	52.6%	50.6%	57.5%

2. Boca Raton, Fla.

Not just for retirees, Boca Raton fancies itself "Silicon Beach," with a slew of tech outfits–many spawned by veterans of IBM, which opened a plant in the city in 1970

4. Bend, Ore.

This one-time logging town in central Oregon has grown by about 50% in the past decade, drawing companies in computer technology, biotech, and aviation

6. Cambridge, Mass.

The home of Harvard and MIT attracts educated workers who nurture countless Internet and biotech startups. The area has the venture capital to fuel them

8. Franklin, Tenn.

Located in one of the nation's wealthiest counties, historic Franklin has a growing technology sector, including a new biotech campus under construction

10. Rockville, Md.

The epicenter of suburban Washington D.C.'s biotech industry, Rockville benefits from nearby universities and federal facilities like the National Institutes of Health

er just where to draw the line between temps and full-time employees. "No one has ever been able to come up with a universal test," says GJ Stillson MacDonnell, an attorney at employment law firm Littler Mendelson in San Francisco. "So we end up being whipsawed between different state and federal definitions."

Representative Jim McDermott (D-Wash.) has introduced a bill that would help clarify the definition of a contractor and increase penalties for companies that misclassify employees. "Far too many workers aren't receiving the benefits and protections they deserve," McDermott says. "This will level the field for companies playing by the rules." —*Anne Field*

The bottom line *The government is stepping up scrutiny of companies using contractors and is working to clarify the definition of a freelancer.*

Business Sentiment

Main Street Gloom vs. Corner-Office Cheer

▸ **Entrepreneurs' outlook hasn't improved much from last year**

▸ **Optimism surveys show a gulf between big and small companies**

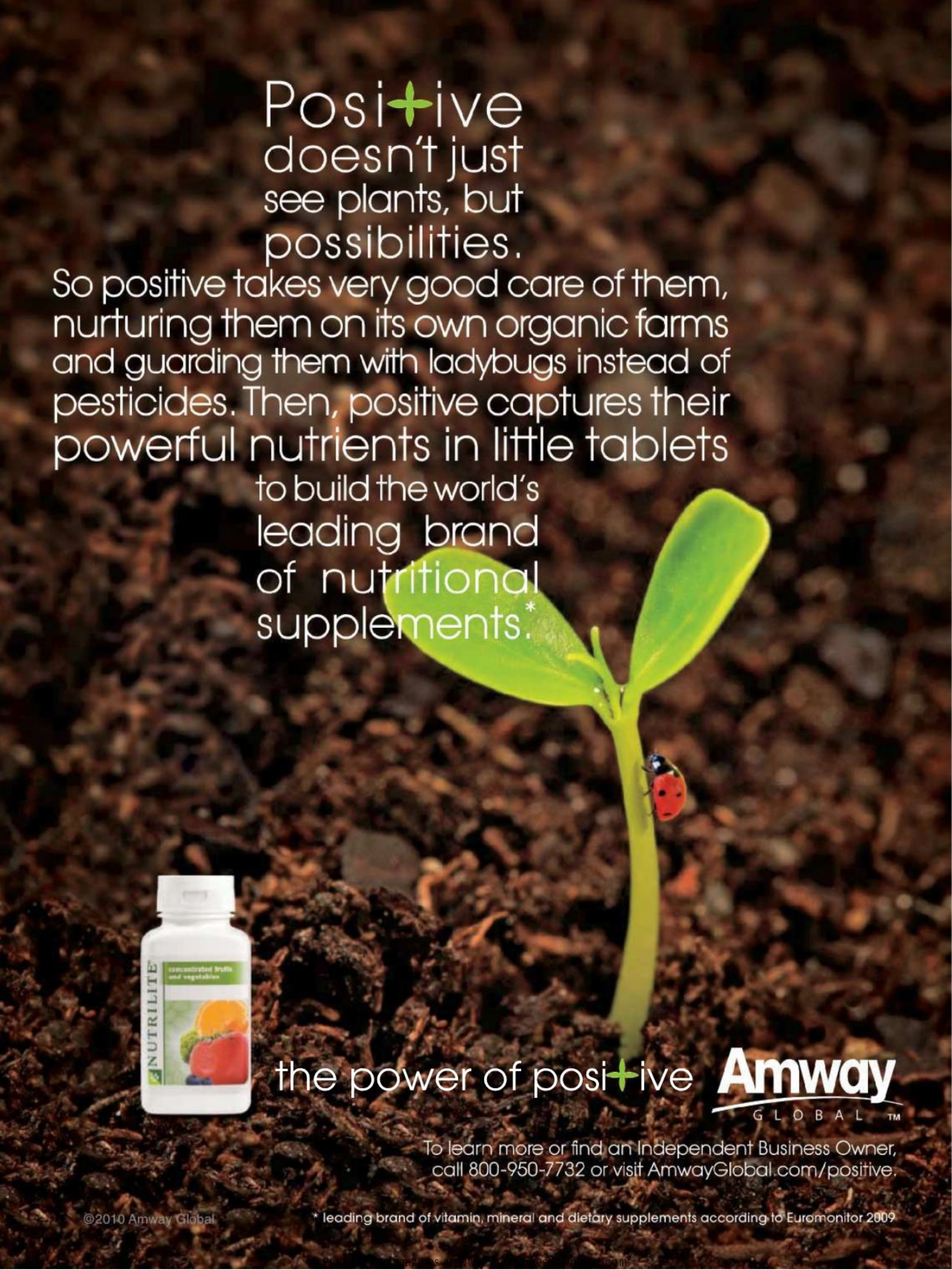
Small-business owners are almost as glum as they were a year ago when talk of "green shoots" began. Sentiment has slipped since January, according to a monthly survey of members by the National Federation of Independent Business. The group's Optimism Index, which reflects sentiment on factors ranging from profit outlook to job openings, remains roughly where it has been for the past 18 months–levels that hadn't been seen since 1980.

Big-company CEOs have a rosier view. Surveys by the Business Roundtable and the Conference Board show their confidence bottomed out more than a year ago. Top executives have expressed more hope than fear for at least two quarters.

Big companies may be less exposed than smaller ones to lingering domestic problems, says Dane Stangler, a researcher at the Kauffman Foundation. "You see a lot of commercial real estate loans held by small banks, which are the banks that loan to small business," he says. —*John Tozzi*

The bottom line *Bigger companies have better access to financing than small outfits, helping them overcome the residual effects of the recession.*

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Vivek Wadhwa

Focus On Enterprise

The People Work the Magic, Not the Politicians

Boulder, Colo., has become the top U.S. city for tech startups. That's largely because of a bottom-up revolution led by entrepreneurs

On a recent morning, a half-dozen young software engineers hunched over laptops at The Cup, a café on bustling Pearl Street in downtown Boulder. They were holding an informal meeting about a social networking app they're developing and seemed to be on a first-name basis with the parade of techies walking through the door.

An influx of entrepreneurs like these has changed the face of this Colorado city of 98,000, making it a destination for Internet startups. With the University of Colorado as an anchor and a backyard full of mountains as lifestyle bait, Boulder now has the highest concentration of software engineers per capita in the nation. It's second only to Silicon Valley in percentage of workers employed in tech, according to the American Electronics Assn. Best-selling author and urban development expert Richard Florida says it has the greatest concentration of the "creative class"–scientists, artists, engineers, and the like–in the U.S.

The university and prestigious research labs such as the National Center for Atmospheric Research and the National Institute of Standards & Technology have long attracted well-educated folks to Boulder. In the 1970s, Celestial Seasonings and StorageTek helped foster a robust natural foods industry and a thriving tech community. Over the years, software, data services, and biotech blossomed as employees of those companies branched out to pursue other interests. The combination of entrepreneurship, engineering talent, and a counterculture vibe gave rise to many pre-bubble Net startups.

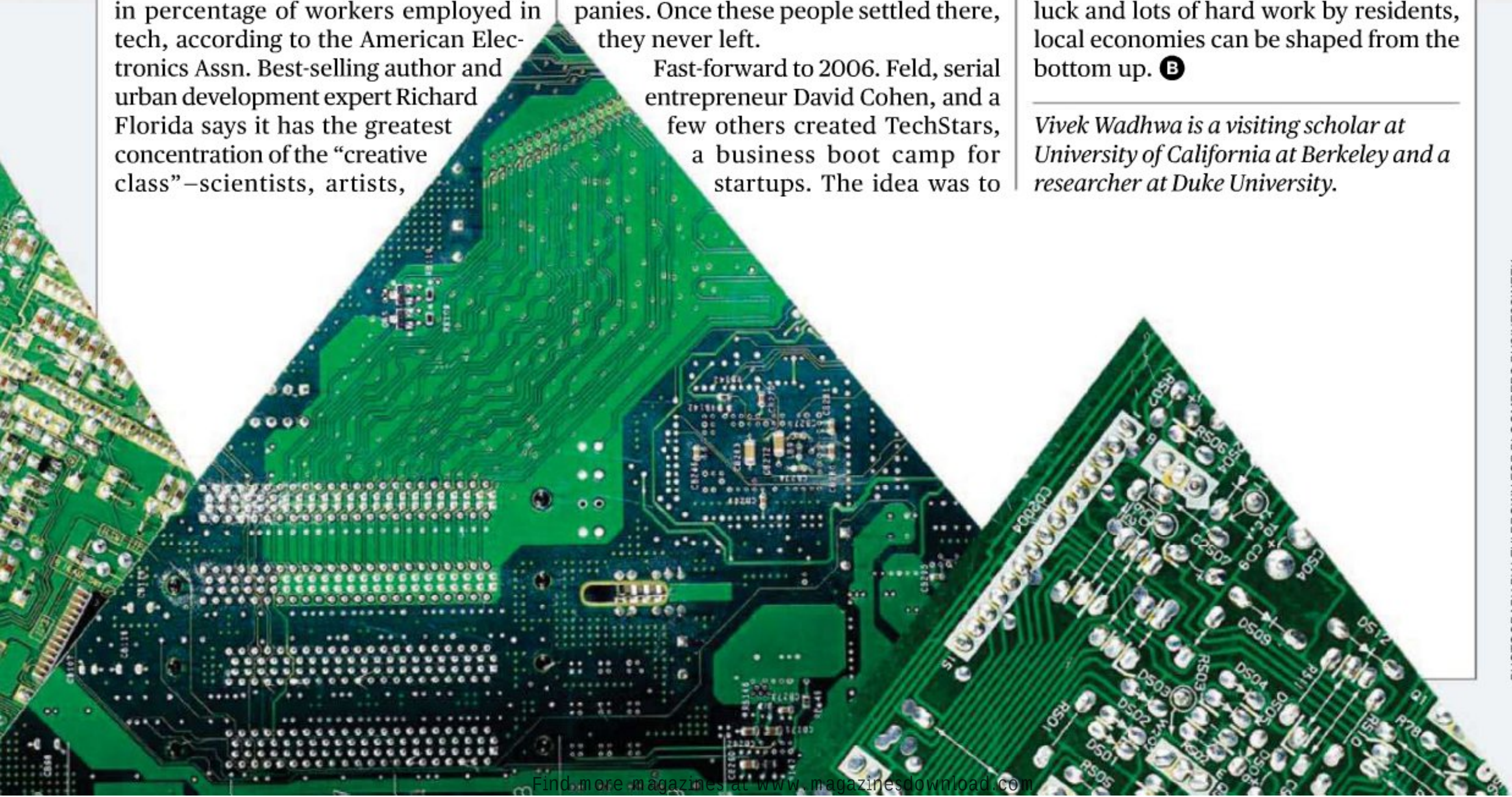
Boot Camp

By the mid-1990s, Boulder had a growing software industry. Entrepreneurs and venture capitalists like Foundry Group's Brad Feld moved to the area and helped launch new businesses. The pioneers soon attracted experienced managers to Boulder to run their companies. Once these people settled there, they never left.

Fast-forward to 2006. Feld, serial entrepreneur David Cohen, and a few others created TechStars, a business boot camp for startups. The idea was to create 10 Internet companies a year by putting them through a 90-day intensive program that would prepare them for seed funding. The founders viewed it as both a training ground and a way to recruit talent from around the country. They enlisted local Internet and software entrepreneurs as mentors to help the newcomers hone their ideas. Soon, events popular with the startup community such as a monthly New Tech Meetup were standing room only. Today, Boulder is considered one of the top places in the country to create an Internet startup. Google, Microsoft, AOL, and Oracle have made acquisitions here in recent years and have growing outposts in town.

When I ask longtime players about local government, they shrug. When I ask them about state government, the common refrain is that the best thing it can do is invest in education and otherwise stay out of the way. The lesson here is that it doesn't take billions in government spending to create a thriving industry cluster. Instead, with a little luck and lots of hard work by residents, local economies can be shaped from the bottom up. B

Vivek Wadhwa is a visiting scholar at University of California at Berkeley and a researcher at Duke University.



PHOTOGRAPH BY LEVI BROWN FOR BLOOMBERG BUSINESSWEEK

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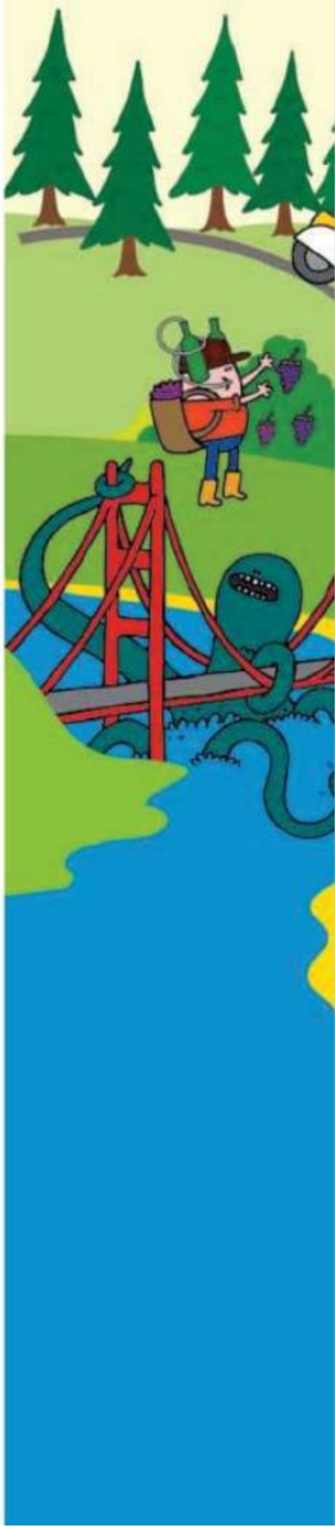
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Organized Chaos

Meg Whitman believes her experience as a CEO can help her save California. Does she have any idea of what she's getting herself into?
By Karl Taro Greenfeld



Portrait — Misha Gravenor
Illustration — Al Murphy

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On the stump in February at the opening of Whitman's Orange County headquarters

Margaret C. Whitman, the woman who made her career in consumer marketing—focus-grouping Mr. Potato Head prototypes for Hasbro, retooling toothpaste for Procter & Gamble, and, of course, scaling eBay into a multibillion-dollar e-commerce monster—is now brand-building her newest product: Candidate Meg.

Here is the product: tall, handsome woman, parade float stately, emerging from a tinted-window black Escalade in waist-length jacket, trousers, and pointy loafers, campaign workers and political consultants in a phalanx around her. In the hot California afternoon sun, her freckled skin appears pale and powder-dry. A few passersby stop and stare. "Is that ... wait a second ... who IS that?" She's familiar, her TV spots inescapable, her serene, almost smug expression and from-nowhere accent (Long Island? Boston? Los Angeles? Silicon Valley? Where exactly is she from?) on those TV commercials an almost soothing soundtrack to California's exasperating crises: "If I could do one thing as governor of California, it would be to fix the business climate ...." The warm monotonous voice of fiscal reason, urging calm, urging change, urging a vote for Candidate Meg.

Candidate Meg now crosses the sidewalk, on her way to her second event of the day, her 12th event of the week, her thou-

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JEROD HARRIS/ZUMA PRESS

sandth of a campaign that began in February 2009, now pitching the product to the Greater San Jose Hispanic Chamber of Commerce. She never quite gets used to this, she has said, the peculiar hustle of taking you, your being, and saying, buy this. Buy me. Buy Meg. Because I am the solution to all your problems, to all of California's vast agglomeration of problems.

"I'm still learning a great deal," Whitman, 53, told me later, as if revealing a secret. "I'm working hard at getting better, every day, every single week."

If the governorship were awarded on the basis of a complicated multiple-choice exam instead of a statewide election, then Candidate Meg would be a shoo-in. (And one gets the sense that she would prefer that method of choosing a governor instead of an endless retail slog up and down a huge state.) When she made the decision to run, Whitman says it was because she wanted to govern; what she knew, but hadn't quite reckoned with, was the inside-out, emotionally draining experience of marketing yourself to tens of millions. She is spending a chunk of her personal wealth—$59 million so far of a personal fortune estimated at more than $1 billion—mostly on ubiquitous TV and radio advertising. But you can't pay somebody else to do all that old-fashioned, pound-the-pavement politicking for you.

The new Whitman is just getting off the ground, and there's no telling how high she can go. There is California, and then there is the national stage, where a natural opportunity awaits. From her pro-choice position to her elitist educational background and blue-chip training, she could be the crossover alternative to the Republican Party's other female star, Sarah Palin. While she lacks Palin's uncanny ability to connect with certain elements of the Republican base—it's hard to picture Whitman shooting moose from a helicopter—she is a far more reassuring figure to many of the GOP's top fund-raisers.

Lavishly paid business leaders tend not to be the most popular people these days. But so precarious is the condition of public finance that ex-CEO office-seekers like Whitman see an opportunity for themselves. Now more than ever, their thinking goes, government needs private-sector discipline and proven corporate cost-cutters. Whitman is the best known of a wave of candidates with corner-office experience: Former Gateway President and Chief Operating Officer Rick Snyder is running for governor in Michigan, wrestling executive Linda McMahon is leading in Connecticut's U.S. Senate Republican primary, and ex-Hewlett-Packard chief Carly Fiorina is in a tight

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Republican primary contest with former Representative Tom Campbell in the California senate race. Even Steve Poizner, Whitman's challenger in the June primary—currently 49 points back in Whitman's wake according to the Field Poll—was the CEO of a tech startup sold to Qualcomm in 2000 for $1 billion.

For her part, Whitman has been stumping loudly and frequently about how she can unleash tech industry innovation on California's fiscal crises—"Silicon Valley is 130 miles from Sacramento," she often says in her stump speech. "But it might as well be a million miles away by how Sacramento operates."

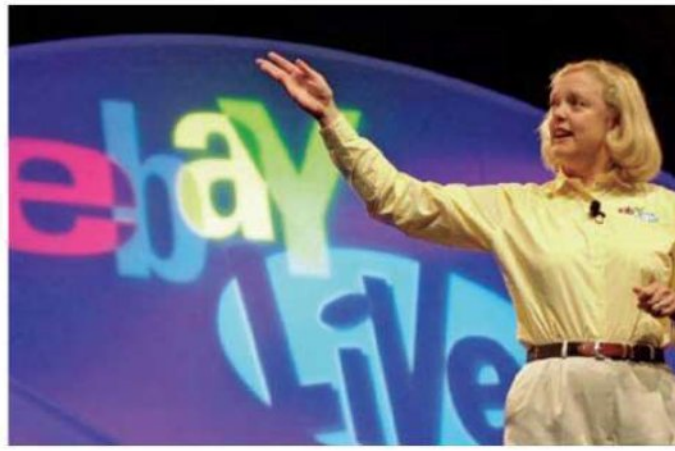
Surveying the mess in California, you might naturally ask why anyone, especially someone accustomed to holding a position of authority, would want to be governor. No state was whacked harder by the successive collapses of technology and real estate. The narcotic prosperity thrown off by those speculative frenzies allowed Sacramento to mask underlying problems by temporarily inflating the tax base and delaying the inevitable budgetary reckoning. The state spent profligately over the last two decades, the budget going from $85 billion in 2000 to $140 billion-plus in 2008, while also cutting taxes. The California civil service added 42,000 jobs in the second half of the last decade, yet property taxes remain capped at 1%, forcing the state into an unhealthy reliance on capital-gains and income taxes.

When those sources of income shriveled in the recession, they left a vast hole in a state where 40% of spending is mandated for public schools because of Proposition 98. Yet the school system ranks 46th in the country for spending per pupil. With a budget deficit projected to surpass $60 billion, California has the worst credit rating in the country. Public schools are laying off teachers, libraries are reducing hours, parks and beaches are closing, welfare and public health programs may be slashed. There is no map for getting back to normal.

Hovering over all the chaos—and beckoning Republican dreamers to dive in and emulate his patented mix of optimism and conservatism—is the still-powerful aura of Ronald Reagan. Across America, every GOP candidate aspires to ownership of Reagan's legacy, but the California statehouse, where Reagan became Reagan, is hallowed ground. Arnold Schwarzenegger, whose name Whitman never utters on the trail, ran as Reagan reborn. She also evokes Reagan on the trail, as a fearless free marketer who showed how to tame bureaucracies and Big Labor and allow the once-great state economy to regain its stride.

The collapse of California's business climate is a particularly mystifying aspect of the state's malaise. How could a place that in the last 15 years incubated Google, Facebook, Twitter, and eBay be hemorrhaging tens of thousands of businesses a year and a million jobs since 2000? Whitman raises the issue repeatedly on the stump, citing her difficulties building a new PayPal headquarters in 2006. "Two and half years of trying to get permission, 25 permits, three consulting firms to navigate the labyrinth of regulations. This was for a building that was to house 3,000 white-collar workers. You would think the State of California would have been my best friend on this." Her argument is that regulation strangles even the most devoted Californians, who instead are taking their businesses to Nevada, Utah, Arizona, or in the case of Northrop Grumman, may be moving to either Virginia or Maryland.

"In business, it's all results," says Whitman's friend, Mitt Romney. "Somebody who performs, you couldn't care less how they talk"



Delivering the keynote speech in 2002 at the first annual eBay Live! conference

Compared with all the other problems facing the state right now, the treacherous business environment hardly fires up large blocs of voters, and the political forces that produced it are more powerful and well-entrenched than they may appear. A probusiness platform is not only tough to run on, it's also hard to make good on. Schwarzenegger sold himself as a fiscally conservative businessman and subsequently presided over the biggest deficits in California history. The conventional wisdom is that he got played by the legislature, but it may be that he just didn't have enough patience. Being governor of California doesn't come with the sweeping powers that a CEO is used to having over her own company. Whitman's capacity to keep going at a problem, to not get bored and lose resolve, could be what it takes to deal with an ornery and uncooperative legislature.

Almost every day, someone asks Whitman why she is running for governor. She responds, almost reflexively, with an argument for competence. "I really believe I can fix it," she says over and over. Of course, she's also running because she has the time and money and she's young enough not to want to spend the rest of her life jetting to occasional board meetings and taking lots of vacations. Whitman's husband, Dr. Griffith Harsh, a neurosurgeon, recalls the moment he first glimpsed the arc of Whitman's post-eBay career. In 2005 he joined her at an eBay Live! event: Legions of the virtual auction site's buyers and sellers gathered in a convention center, networking, swapping tips, and, of course, meeting Meg, the CEO of the company that had enabled the creation of more small businesses than perhaps any

SUSAN GOLDMAN/BLOOMBERG

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other in history. She stood in the center of the convention floor, in a canary spread-collar shirt and blue pants, smiling, greeting her community—even bending to tickle a baby. "I could see something in her," says Harsh, "in the way she was smiling and loving the attention and shaking hands and posing for photos, that made me think, 'hmmm, maybe politics.'"

The transition has required "a different processing speed," says Whitman. She compares it to a two-year-long, pre-IPO road show, only "you don't get to throw it over to your CFO for 20 minutes."

Her old boss at Bain & Co., former Massachusetts Governor Mitt Romney, describes campaigning as "the opposite of being a great CEO." Before co-chairing John McCain's Presidential run, Whitman in 2007 was the financial co-chairwoman of Romney's primary challenge; it was Romney who urged her to run for governor, helping push Meg past "maybe" in early 2009.

"Winning an election isn't easy for a businessperson," Romney says. "The most difficult part is the communications part of the campaign. In business it's all results, and talk is irrelevant. And somebody who performs, you couldn't care less how they talk. Look at Jack Welch, one of the great performers in American history, but he wouldn't have been able to make the transition Meg is making."

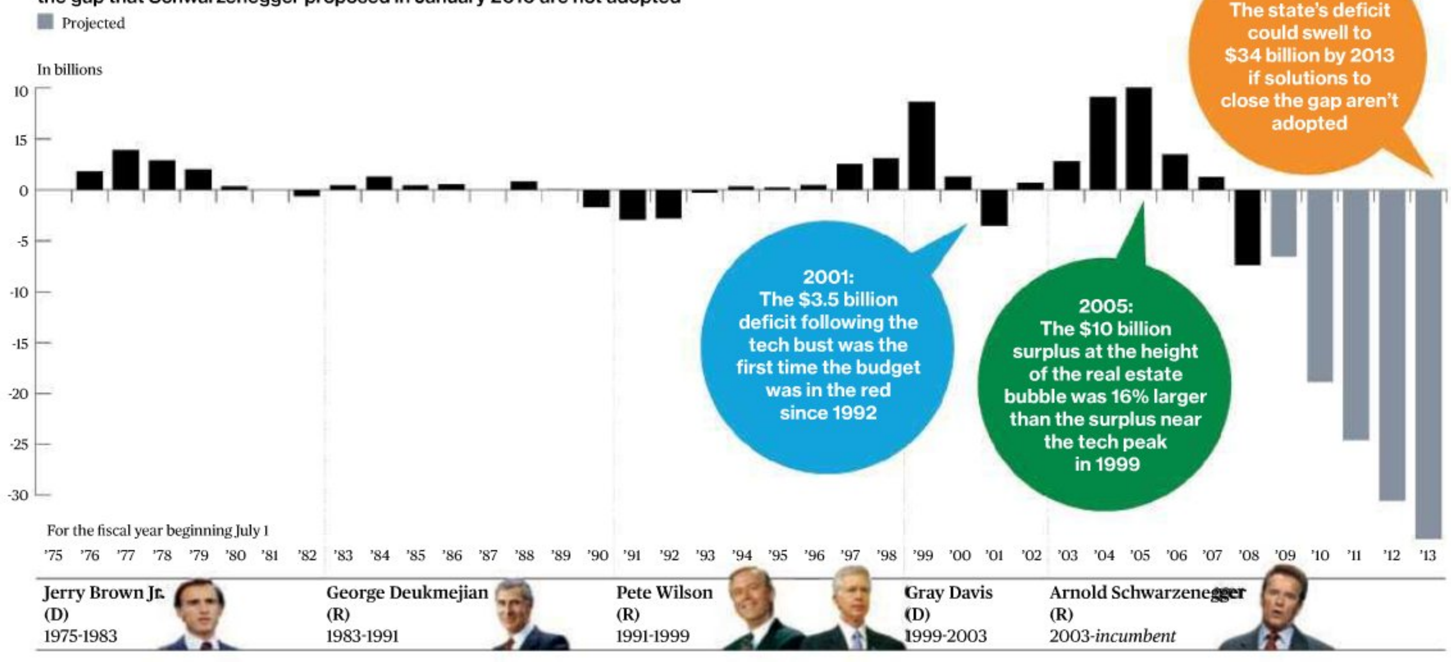
Whitman's own staff admits she isn't a natural, though they quickly add that she has the drive to remake herself into a winning candidate. "She is so competitive," says communications strategist Rob Stutzman. "She wants to govern, and to do that she knows she needs to become a better campaigner to get there. I worked for Arnold Schwarzenegger, who loved campaigning more than the governance. She's not like that. But that's what compels her to get better and better at this."

Government needs to get out of the way of the American businessman. It's a core GOP talking point, but the Schwarzenegger administration has demonstrated that even conservative voters are sensitive to the difference between passive and ineffective government. Schwarzenegger's approval ratings stand at 23%, right where Gray Davis's were when he was recalled, the lowest scores registered by a sitting governor in 50 years. Whitman trusts her own judgment and intelligence; she believes governing will come naturally. She guided eBay, an organization of 15,000 (larger, by the way, than the population of Wasilla, Alaska), from tiny startup to tech titan. But she never had to think about education, health care, or a rebellious legislature while doing so.

Yet it's Whitman's business background that her backers always point to when explaining why they have such faith in her ability. After graduating from Harvard Business School, she was one of four women out of 100 people hired as brand assistants at P&G in 1979. Two years later she moved to Bain in San Francisco, again one of just a few women in the office. There she developed a reputation as a budget genius, urging clients to centralize purchases, and discovering, for example, that food service concessions at universities could save hours of prep time by washing potatoes in dishwashers. "The thing about these kinds of savings is, you have to look for them," Whitman explains, "These are not splashy, career-making projects that get you promoted."

Debt in the Golden State

Projected cumulative balance of the state's General Fund assumes the solutions to close the gap that Schwarzenegger proposed in January 2010 are not adopted



DATA: CALIFORNIA DEPARTMENT OF FINANCE

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Whitman did get promoted, though. She moved from Bain to Walt Disney in 1989 and oversaw the expansion of theme stores overseas before getting her first CEO position at Florists' Transworld Delivery in 1995 (where her tenure was brief and mostly unhappy). When a headhunter called her about eBay she was at Hasbro, reviving the Playskool and Mr. Potato Head franchises.

Her success at eBay starts with the obvious: She expanded the company from 30 employees to 15,000, took it public, and raised revenues from $4.7 million to $7.7 billion. Adam Cohen, in his book about eBay, *The Perfect Store*, describes her response to a cataclysmic 22-hour site crash in 1999 as an "unlikely Winston Churchill, in the middle of it all, issuing orders and deploying troops as the Blitzkrieg raged around her." Whitman became the de facto chief technology officer during the crisis, and upon its resolution had her new CTO's desk put in the cubicle next to hers. She became one of the most respected figures in the corporate world, and eBay became a global powerhouse, establishing dominant positions in Germany, India, and South Korea.

There were missteps, too. EBay got trounced in the lucrative Japanese market by Yahoo! and squandered an early lead in China. (Whitman traveled frequently to Shanghai for a few months in vain hopes of reversing the slide in the company's market share.) Her signature moves were a mixed bag. The $1.5 billion acquisition of PayPal in 2002 was a massive hit, ranking as one of the smartest big deals of the dot-com era, not least because it was executed after the bust when the company was cheap; her 2005 purchase of Skype, the Internet telephone service, has been widely criticized as an overreach, $3 billion for a company with minuscule revenues. Worse, Skype didn't complement eBay's core business, and will probably be spun off later this year at a loss of as much as $1.7 billion.

Throughout her career Whitman demonstrated a flair for the undramatic, for doing her chores well and showing little vanity. But after building eBay into a global company that was poised to compete head-to-head with Amazon.com, she lost her way, says Standard & Poor's analyst Scott Kessler, who has covered the company since 2000. "The core business had matured, he says. "Whatever vision she had about where to take the company from there was muddled." Whitman left eBay in 2007 not quite as damaged goods, but with serious questions about how much of her success there was due to being at the right place at the right time.

"I'm a big believer in focus," says Whitman. "And when I focus, I can do a lot of things.... Well, I'm really focused now"



Governor Schwarzenegger and the candidate in Los Angeles

JONATHAN ALCORN/ZUMA PRESS

A certain vision deficit is apparent on the campaign trail. Delivering her prescriptions for California, she speaks in numbered sentence sets—"four problems," "three areas," and "two issues." Her platform is built around "three primary goals," namely creating jobs, cutting spending, and fixing education. Whatever doesn't "fit in those baskets," she vows, will no longer be prioritized. It's PowerPoint politics, willfully dull and unglamorous. It's also elementary; what part of the governor's job doesn't fit into one of those areas, which could also be classified as economy, education, and state budget?

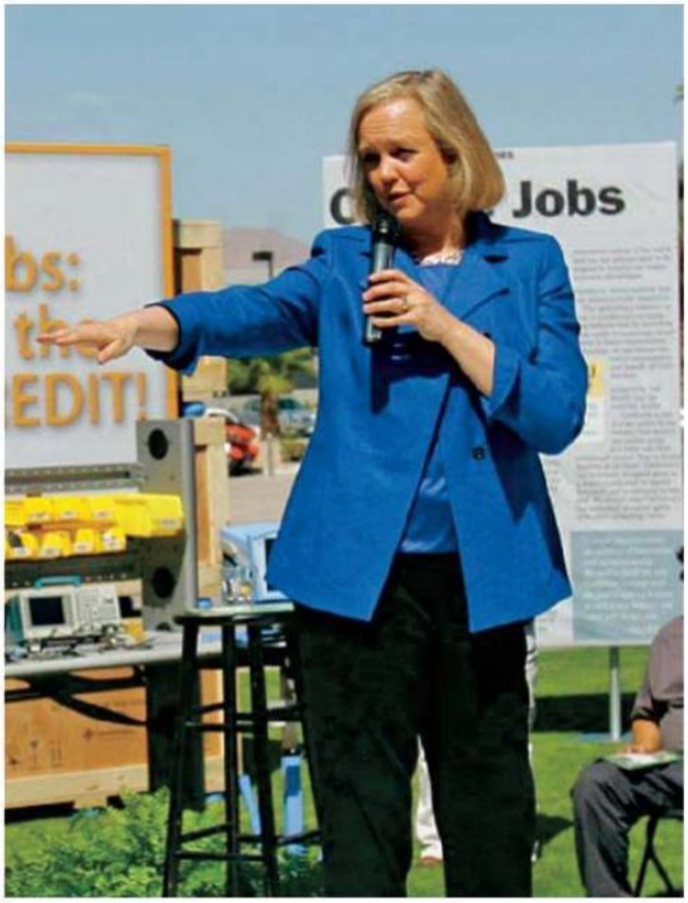
The most gifted politicians manage to turn scripted "messaging" into stirring stump material, but there is nothing Churchillian in Whitman's delivery. Says former colleague Rajiv Dutta, former eBay CFO and PayPal president, now a managing director at Elevation Partners: "Clearly she doesn't have the practiced ease of appearing to be intimate in front of millions, which career politicians have spent their lives perfecting."

A more experienced campaigner—say, Attorney General and former Governor Jerry Brown, Whitman's likely opponent in the general election on Nov. 2—might be able to exploit this weakness. It's hard to imagine Brown, former Governor Moonbeam, as the more approachable candidate, but that's how the race is shaping up. Brown is unopposed in the Democratic primary and has barely stepped out on the trail—yet the Whitman camp is already attempting to frame him as the politics-as-usual candidate, owned by the special interests that Whitman's personal wealth insulates her from. "I contrast myself to Jerry Brown," she says, "who is 100% beholden to the unions." Early polls have the race as a dead heat.

At Seal Beach's Leisure World, a retirement community south of Long Beach, seniors drive electric buggies plastered with "Nobama" stickers to the Meg Whitman rally. After the singing of *God Bless America*, *America the Beautiful*, *My Country, 'Tis of Thee*, and the national anthem, the candidate appears just in time for the Pledge of Allegiance. This afternoon rumors about what is in the Health Reform Bill are sweeping through the hall. At one point Elizabeth, the octogenarian next to me, says, "They're going to have IRS agents deciding who can go to the doctor."

This isn't Whitman's natural constituency, but she does fine, enduring a few muted boos when her opposi-

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Whitman in April at a Palm Springs medical equipment company

OMAR ORNELAS/THE DESERT SUN/AP/PHOTO

tion to offshore drilling is raised. Backstage after the rally, it takes a few minutes for Whitman to veer away from the campaign speech and into an actual conversation. She is seated on a wooden chair, eagerly sparring with reporters in her usual attire of blouse, short jacket, slacks, and pointy pumps. Whitman spent most of last year held in check by her staff after a few awkward interviews, notably when she defended her sparse voting record to reporters at the state Republican convention last September—including not casting a vote for the governor recall in 2003—by explaining, "I was focused on raising a family, on my husband's career, and we moved many, many times." She has since tempered her imperiousness—perhaps that's what Romney means by "communication"—and now says she enjoys the back and forth of these exchanges.

"I want the campaign to get better, be ready for the next challenges," Whitman says. "I love the policy part of it. It's been fun to dig in on that." In a debate with Poizner, she announced that she would suspend for a year the state's compliance with Assembly Bill 32 that requires California to reduce emissions by 25% in a decade. She is the first candidate for governor to publish her own detailed policy statement, "Building a New California," in which she lays out more of her ideas, all of which fit broadly into her three primary goals. While she has not gone as far as some of her fellow Republicans in demanding across-the-board tax cuts, Whitman has said she will give targeted tax cuts to businesses and a $10,000 tax credit for home purchases. Her education reform ideas revolve around finding efficiencies that allow more money to reach the classroom. Also, she wants faster-track charter school conversions so parents can "immediately" petition to turn a failing school into a charter school. And in classic Reagan mode, Whitman plans to cut the state bureaucracy by 40,000 employees, though her opponents have pointed out that the governor's office only has authority over half the workforce, including public safety, which she says she will avoid cutting. So getting to 40,000 will be especially tricky, if not impossible.

On a late afternoon this spring, Whitman is at home in Atherton, a picture-perfect Silicon Valley suburb. Her house is vast but tasteful, a colonial with green shutters, set back from a picket fence amid a garden bristling with old-growth willows, redwoods, and blue spruces. She sits on a white sofa with her legs folded beneath her, wearing a three-button black jacket, jeans, and no shoes. She picks absentmindedly at her toes as she speaks. In this kind of casual setting, the preppy high school athlete and Princeton University graduate comes closer to the surface. There's a lightness and charm that she has not yet figured out how to project in a bigger room. The run for governor of California, she admits, is harder than she expected.

"This has been new," she smiles. "Campaigning is really different than being the CEO of a company, where you are leading a team.... In campaigning, there is really only one asset—me—so it's one giant linear program for one scarce resource. It's been a challenge, but a fun challenge." After she says "fun," she forces another little smile, one that shows plenty of teeth but doesn't move the pale skin around her blue eyes.

"I'm a big believer in focus." She nods. "And when I focus, I can do a lot of things. I learned that in business. Well, I'm really focused now."

As you watch Whitman travel the state, doing two events a day, you can see the slow, incremental payoff of that focus. She seems to have absorbed the critique of observers like Raphael Sonenshein, a California State University Fullerton political science professor, who says "she projects competence, though seldom likability," and is working hard to be warmer and more engaging.

Of course, if Candidate Meg does become Governor Whitman, that might be when her real problems start. For 30 years the office has devoured its occupants, crushing the personal reputations and good intentions that got them elected. For Whitman, it could all come down to timing. If the California economy somehow comes roaring back, either from her policies or a renewed tech boom feeding off global demand, the state's budget crisis could become a lot more manageable, and that might be all the turnaround she needs to vault into national politics. How much would the Republican Party love to have a certifiable non-Palin star who brings 55 electoral votes along with her? Many will argue that she can't compete nationally with her moderate social views. Many will say an elitist from California can never connect with Iowa farmers or New Hampshire quarrymen.

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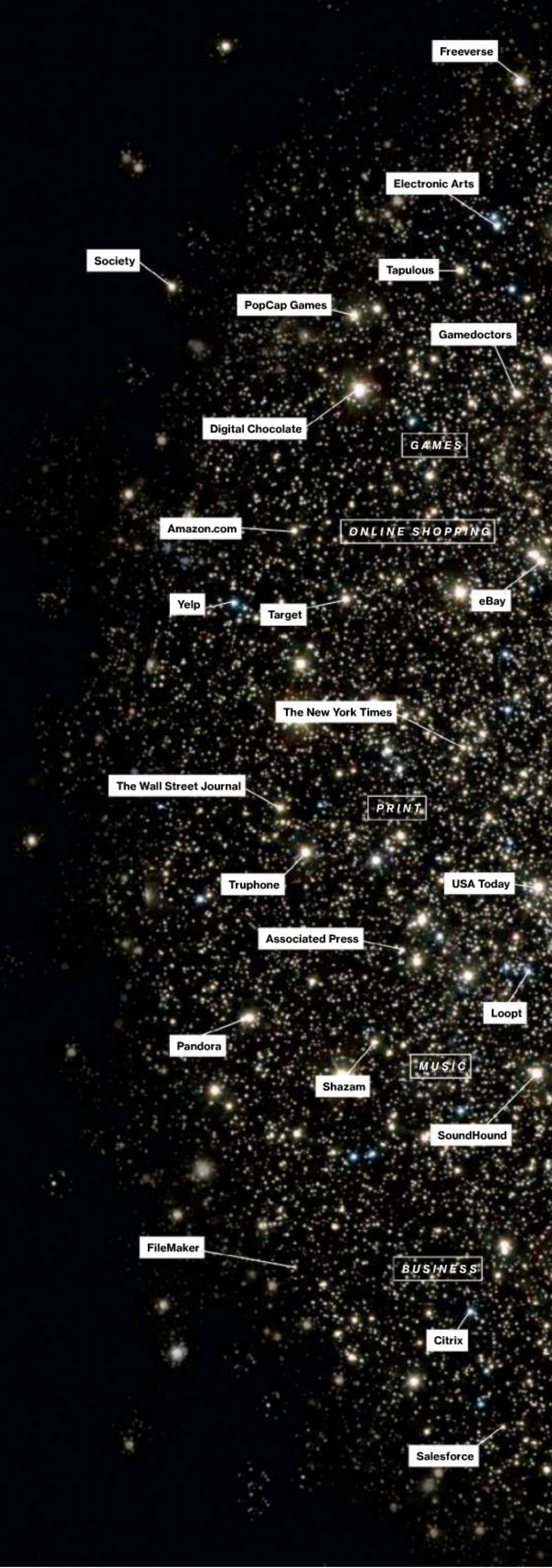
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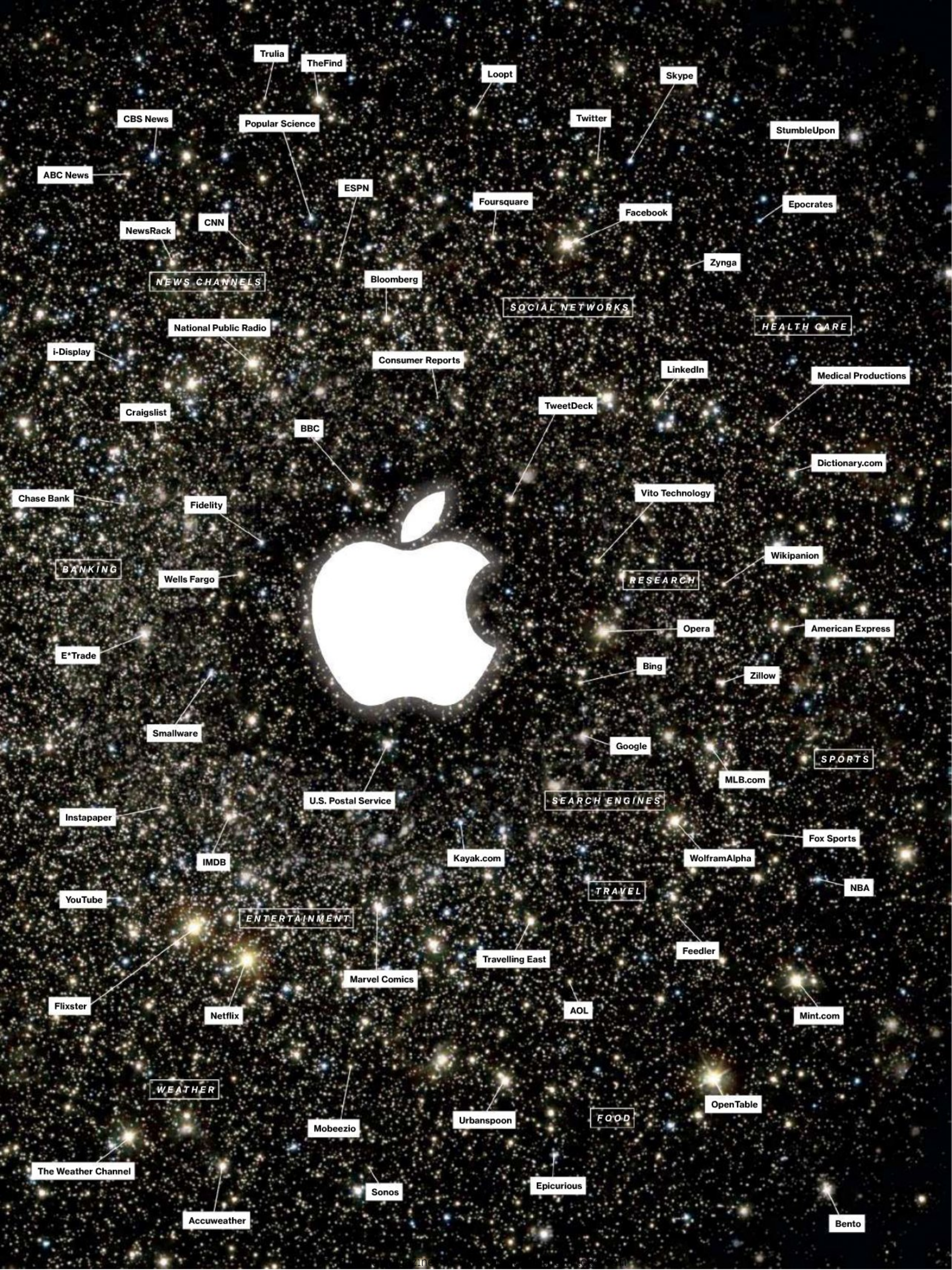
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Apple's Endlessly Expanding Universe

By Peter Burrows



In 2008, Steve Jobs said, 'Let there be Apps.' Now a cosmos full of companies and developers is bound by the laws of Apple — for better and worse


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Popular Science
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Facebook
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Five days after the product launch of the decade—we're talking about the iPad if you hadn't guessed—Steve Jobs was fielding questions at a press conference on Apple's Cupertino (Calif.) campus. The iPad release had been a stadium-style show, full of stagecraft and choreography meant to wow a global audience. The follow-up was more like a club gig for the truly devoted. The purpose was to show off some improvements to the software that powers the iPad, as well as the iPhone and the iPod touch. Surrounded by journalists and bloggers as interested in the guts of his creation as its flawless skin, Jobs, still gaunt from a cancer-related liver transplant about a year ago, was loose and commanding, his energy and wit at full force. Asked why Apple hadn't yet included the ability to run small, portable chunks of code called Widgets on the iPad, he grinned. "We only shipped it on Saturday," Jobs said. "And on Sunday we rested."

It was a joke, of sorts. Apple is not divine—though anyone who rode the stock from $3 to $247 since Jobs' 1997 return to the company might disagree. What Apple has come to resemble is an endlessly expanding cosmos. More than 85 million iPhones and iPod touches are in existence, up from zero in July 2007. IPhone users have downloaded 4 billion apps from Apple's App Store, and more than 10 billion songs, 33 million movies, and 250 million TV shows from iTunes. IPhone owners, who make up just 2.2% of total mobile-phone consumers worldwide, according to market research firm IDC, chug 64% of all mobile browsing minutes, says Net Applications, another research firm. According to Apple, 500,000 iPads have already been sold, increasing the number of people who have access to a rich life, full of endless media and communication options, without ever leaving the Apple platform.

Apple's neatest trick is that this platform would expand even if Apple were sitting still (it's not). Forget Apple's 34,000 salaried employees. More than 125,000 developers now work to make apps for Apple products. Apple pays them nothing. They sign contracts agreeing to Apple's rigorous terms in the hope that users will buy their apps or view ads on them. In the hope, really, of becoming another little planet orbiting Apple's sun—with the truly lucky ones landing a spot in the company's TV spots.

In the quarter ended Mar. 31, the company blew past analysts estimates with sales growth of 49%, to $13.5 billion, while profits soared by 90%, to $3.07 billion. That included record sales of the iPhone, up 131% from the previous year. Jobs even broke from his typically tight script to note: "We have several more extraordinary products in the pipeline for this year." That could be because a midlevel engineer celebrating a birthday left a prototype of an upcoming iPhone model in a bar on Apr. 18, stealing the element of surprise. Still, there's little doubt Apple remains on the march into new markets, creating even more of a reason for developers to hitch their wagon to Apple.

For Apple, it's a Wintel-like cycle in which new Apple hardware drives the creation and purchase of new apps. Except it's better than Wintel; the combination of Intel processor running Microsoft's Windows operating system never really managed to leap from PCs to other devices. Apple has

Maggiotto's company, Zinio, enables iPad users to read 2,400 magazines



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How Apple Opened Up
—and Made a Fortune



1977

Apple's first hit, the **Apple II**, takes off in large part due to the spreadsheet program VisiCalc. In the 1980s, thousands of programs such as Aldus' Pagemaker, for desktop publishing, make the Mac a hit.

1995

Microsoft's focus on compatibility lures hordes of PC and software makers to support Windows. After Windows 95 sets off a PC boom, many software shops give up on the Mac altogether.



2003

Apple's new **iPod** music player launches as a closed device that excludes non-Apple software. Apple exerts total control of the catalog and price of music on the iTunes Music Store and refuses to let purchased songs work on non-Apple devices.



2007

Apple introduces the **iPhone**—with an iPod-like plan to say what users and software developers can do with it. Other than an on-board browser to let users access the Web, Apple expects customers mostly to use a few apps created with marquee partners.



2008

After developers lobby to be able to write their own iPhone apps, Jobs opens an **App Store**. Apple is overrun with submission requests from developers that want to sell to the millions of iPhone customers. Within two months 100 million apps have been downloaded.

2009

Apple streamlines developer requirements, speeding approval of thousands of apps every week. To promote sales, it runs "There's an App for That" TV ads and enhances technology so developers can sell songs, game upgrades, and such from within an app.



2010

The **iPad** era begins. Rather than control distribution of music, newspapers, and other content through iTunes, Apple lets developers create apps to make money as they see fit. In June, Apple will launch iAd, a way advertisers can create ads to run within apps.

constructed its empire so that almost anything you buy on iTunes—and Apple has your credit-card information with your first purchase—can run on any future iProduct. "The laws of nature say that [Apple is] making too much damn money, that this has to be unsustainable," says David J. Eiswert, who runs T. Rowe Price's $312 million Global Technology Fund. "But who is going to stop them?"

Plenty of companies fancy themselves contenders, including Microsoft, Nokia, Research In Motion, and Google. All have certain competitive advantages. RIM continues to be the choice of the e-mail-addicted, while Google's search profits allow it to fund free Android software, and possibly free mobile hardware in the future. Yet Apple's head start in apps may be too great to overcome. More than 185,000 apps are available in the App store, compared with 38,000 in Google's online store for its Android mobile software platform. Thirty-five thousand new iPhone apps have been produced since February, even as many developers have been working on offerings for the iPad. "That's a lot of developer attention that's not going to Android," notes Bart Decrem, CEO of Tapulous, which makes music-themed iPhone games that are played by 8 million iPhone owners every month.

That means Apple's future growth is as much a matter of managing its collaborators as beating its competitors. At a public interview in 2007, in which he shared the stage with Bill Gates, Jobs noted that in its early days, Microsoft was much better at forging partnerships than Apple. "I think if Apple could have had a little more of that in its DNA, it would have served it extremely well," said Jobs. "I don't think Apple learned that until, you know, a few decades later."

How well Apple has learned the lesson is evident in the ways it has encouraged app development. Developers keep 70% of the retail price of each app sold by Apple. This summer, Apple will roll out iAd, a mobile advertising platform that lets advertisers make inventive messages appear inside apps. Developers will keep 60% of the revenue.

Strings are attached, however. In the fine print of the new developer contract are strictures that could hurt or even kill many developers' plans. Apple has always banned apps built with Adobe's Flash technology because it views Flash, the program that animates some 75% of video on the Web, as buggy and battery-draining. While many software experts agree, it's also true that banning Flash means that apps developed for the iPhone won't work with non-Apple devices. The new contract takes Apple's war on Flash even further: Apple outlaws any software that translates Flash-based apps into iPhone-approved ones. "Apple has gotten better at working with developers the same way a chess master gets better at playing with pawns," says David Howell, CEO of iPhone app maker Avatron Software.

The tougher terms for developers could also hurt companies that make money through data gathered from iPhone users. Because Apple knows so much about users—from what songs they like to where they are at any time, thanks to GPS—its devices present a unique opportunity for targeted ads. At the moment, ad network operators worry Apple may soon decide it wants to keep that data to itself. "We don't believe we're affected by the new rules, but man, they're volatile," says Wade Beaver, CEO of DoApp, a small app developer in Rochester, Minn. "It makes me wonder whether I want to build my busi-

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ness around a company that could decide to change its business model at any time. That could put me out of business."

Google would be one of the biggest losers if Apple continues to raise the wall around its garden. The search giant snapped up mobile advertising market leader AdMob last fall for $750 million when Apple mistakenly let a no-compete period lapse on its own roughly $600 million AdMob bid, says a source with knowledge of the deal. Google CEO Eric Schmidt was so intent on buying AdMob that two people with knowledge of the deal say he agreed to pay a "kill fee" of around $700 million if the deal failed to close for some reason, such as an antitrust motion from the Justice Dept. Google spokeswoman Jane Penner declined to comment on the terms of the deal.

Apple claims these policy changes aren't meant to hurt competitors, just help consumers. Jobs argues that avoiding Flash and refusing to let outside ad networks gather user data are moves that protect his customers. Yet Apple's omnipotence—and the lack of an obvious structural monopoly à la Windows that would invite regulation—leaves the Apple universe subject to the whims of its creators.

Jobs proudly notes that Apple sells no porn-related apps through the App Store. Yet political cartoonist Mark Fiore had his app rejected last December based on a clause against apps that "ridicule" public figures. The case became a cause célèbre after Fiore won a Pulitzer Prize on Apr. 12. Two days later, Fiore got what he says was a sheepish call from an Apple staffer, and on Apr. 20 his app showed up on the App Store. "But how many people are doing good satire out there and getting rejected?" says Fiore. "The only reason they're talking to me is because I'm in the middle of my 15 minutes of fame."

Despite his misgivings, Fiore resubmitted his application. Such is the lure of Apple's market power. Developers, many of them tiny startups, can write a single version of their app and reach the roughly 100 million Apple customers. On other platforms, they would need to create dozens of versions to work properly on dozens of less popular devices, each with different screen sizes and keyboards. Currently, 60 devices work with Google's Android software, and dozens more are in the works, says analyst Kevin Restivo of IDC. That makes Google's perceived advantage—a bounty of Android hardware—a weakness in the eyes of many developers. "So far we've decided it would take more time to port an app to another platform than it would be to just write a new app for the iPhone," says Avatron's Howell. Avatron's app, designed to transmit work files wirelessly between a PC and Apple's devices, has brought in $1.5 million in revenue since its 2008 release. That's enough

"Apple has gotten better at working with developers the same way a chess master gets better at playing with pawns"
—DoApps' Wade Beaver



Jobs and Google's Eric Schmidt met for coffee in late March

PHOTOGRAPH BY GIZMODO

for Howell to pay his seven employees a Silicon Valley living wage. On the other hand, he says, "I haven't heard about any Android success stories." Google spokesman Anthony House says, "We don't track the success of individual Android developers, but we're extremely happy with the breadth and quality of the apps available in Android Market."

For all the restrictions, most developers feel that obeisance to the laws of the Apple cosmos is worth it. For years, San Francisco's Zinio has made digitized copies of 2,400 magazines available on its Web site. Once iPad owners began busily playing with slick, touch-controlled versions of such publications as *The New York Times* and *USA Today*, it was a natural next step to get Zinio's iPad app. By Apr. 11, Zinio's reader temporarily spiked to become the fourth most popular free iPad app. That led to a 300% increase in revenue from the pre-iPad era. And making the app, says Richard Maggiotto, Zinio's CEO, was easy. "The back-end stuff the developer sees is as well done as the products the consumer sees," he says.

That may be Apple's greatest advantage. In order to develop products just as he wants them, Jobs has shown a willingness to do more than his rivals. PC makers such as Dell and Hewlett-Packard are powered by Intel and run Windows by Microsoft; neither has shown interest in the costly job of building unique operating systems or designing its own chips. Apple does both. Microsoft and Google have only recently decided to design their own mobile devices, and in most cases they're purchasing "white label" hardware from other manufacturers and branding it as their own. The iPad's 10-hour battery life is a result of Apple's ability to have its chip, software, and industrial designers work together to limit unneeded power use.

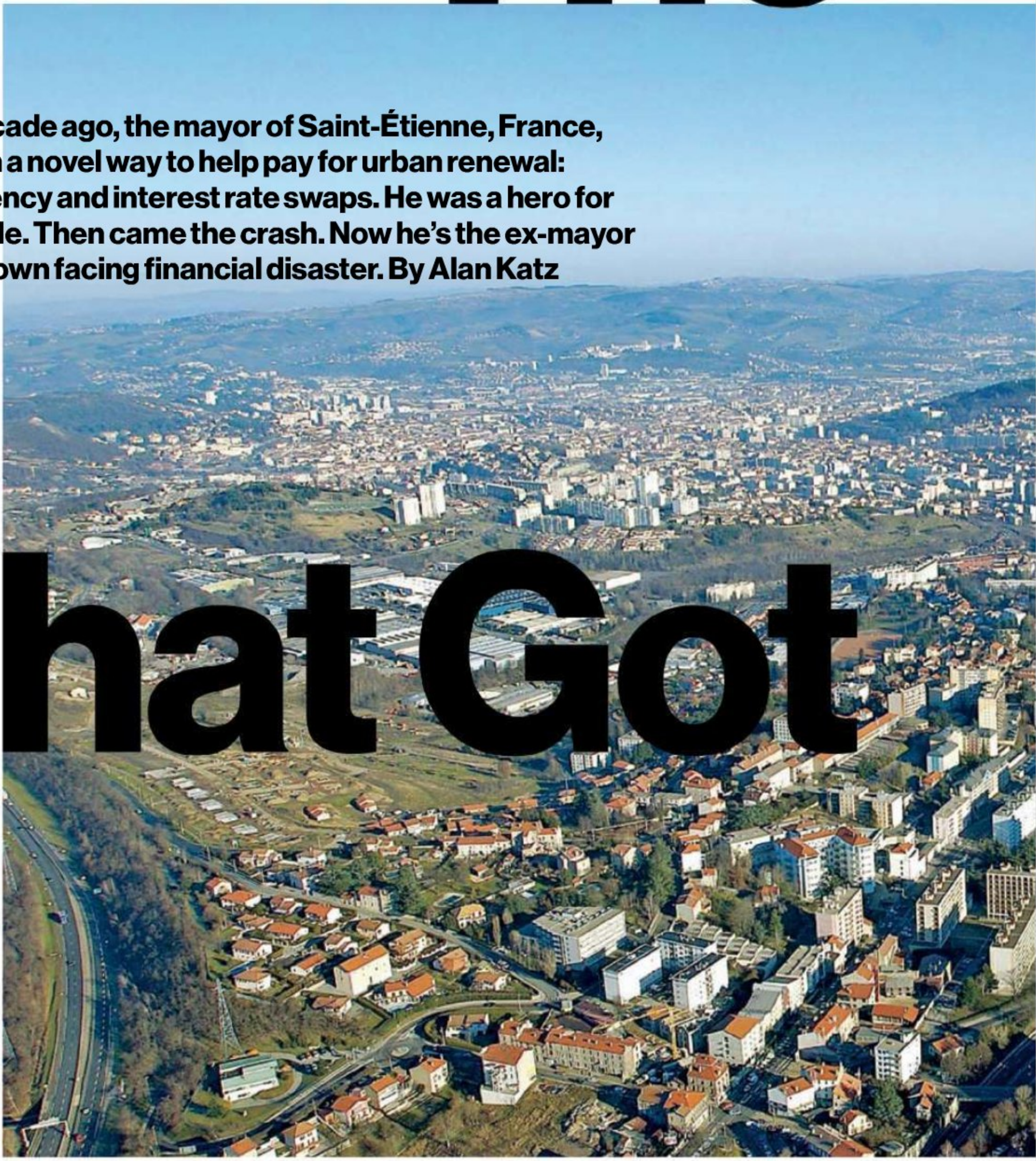
All this eases the tech-buying public down the path toward Apple; iPhone's smartphone market share is currently 25.4%, according to comScore. And as long as the company exerts a gravitational pull on consumers—and manages to balance the rewards to developers with pushing them around—the apps will just keep coming. "How willing you are to expose yourself to that relationship is directly related to how much revenue you can make," says DoApps CEO Beaver. "You'll take a lot, if you're making a lot of money." B

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The

A decade ago, the mayor of Saint-Étienne, France, hit on a novel way to help pay for urban renewal: currency and interest rate swaps. He was a hero for a while. Then came the crash. Now he's the ex-mayor of a town facing financial disaster. By Alan Katz

That Got



Perched on the mega-debt faultline: Saint-Étienne in the Loire

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City Swapped

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In 1995 an ambitious Frenchman from the Loire city of Saint-Étienne took a trip to Baltimore. Michel Thiollière had been elected mayor that year, and he was visiting faded industrial cities—Cleveland, Pittsburgh, Glasgow—to pick up urban renewal ideas he could apply in Saint-Étienne, a coal and textile town of 180,000 that had been in decline for decades. A former English teacher at the Lycee Honoré d'Urfé, Thiollière came home with big ideas but needed capital to implement them. By 2001, with the help of his deputy mayor for finance, Antoine Alfieri, he began buying complex financial products to reduce the city's debt and free up cash.

The products—interest rate swaps and other derivatives whose values were based on such exotic metrics as the difference between long-term rates in the U.K. and short-term rates in Japan—performed as advertised for a while. Thiollière and Alfieri cut finance costs by 12 million euros as the city signed deals with French banks Dexia, Natixis, and Crédit Agricole, and foreign lenders Depfa, Royal Bank of Scotland, and Deutsche Bank. The moves allowed Saint-Étienne and its neighboring towns to build a design center, a 7,200-seat theater, a second streetcar line, even a new business district near the train station. Four years ago, Thiollière was named the fifth-best mayor in the world by City Mayors, a London-based think tank.

Saint Étienne's luck changed in 2008 as the global financial crisis turned interest rates on their head, sparked wild currency swings, and made some banks unwilling to renegotiate contracts. Thiollière was turned out of office. And, inevitably, the bills started coming due. The first arrived this month, two years after he left, as the embedded financial obligations he agreed to began to blow up.

The 800-year-old town owed 1.18 million euros ($1.61 million) to Deutsche Bank as of Apr. 1. The new administration, led by Mayor Maurice Vincent, refused to pay; last November it filed a lawsuit arguing that the bank hadn't adequately explained the risk and that Thiollière didn't have the right to sign the contract. (Deutsche Bank disputes those claims.) The move dodged, for now, the fallout from one of the 10 contracts still in force, deals so exquisitely speculative that no bank will buy them back, says Cedric Grail, 38, who was brought in as municipal finance director in October 2008. The 10 contracts, he says, would cost about 100 million euros to cancel today.

The savings Saint-Étienne generated were far smaller than the risk it loaded onto itself during what Grail describes as "a constant sprint to stay out front. It wasn't a race to keep the city hedged. It was a race to mask potential losses, because the more risk you take, the more potential losses you can hide." Sitting in his office in Saint-Étienne's 19th-century city hall, a grand stone building whose arched facade is inscribed with the words *Liberté, Egalité, Fraternité,* Grail points to a chart of the 10 contracts. "It's a joke that we're in markets like this," he says. "We're playing the dollar against the Swiss franc until 2042."

Saint-Étienne is one of thousands of public authorities across Europe that tried to shave borrowing expenses by accepting derivatives deals whose risks they couldn't measure. Now they may be on the hook for billions of euros in debt, a burden that will likely plague them for the next generation. From the Mediterranean to the Pacific coast of the U.S., officials in government, public agencies, and nonprofit institutions have lost billions of dollars because of transactions they didn't grasp. Harvard University last year agreed to pay more than $900 million to terminate swaps that assumed interest rates would rise. Jefferson County, Ala., almost went bankrupt two years ago because of interest rate swaps it bought to hedge a portfolio of variable-rate bonds. Swaps and other complex, unregulated derivatives are what Warren Buffett famously called "financial weapons of mass destruction." (Another form of credit derivative, the synthetic collateralized debt obligation, is at the heart of the SEC's civil suit against Goldman Sachs, page 13.)

Under the interest rate swap deals popular with European municipalities, a bank would agree to cover a locality's fixed debt payment and the government or agency would pay a variable rate, gambling that its costs would be lower but taking on the risk that they could be many times higher. "This is speculating in the hopes of gain," says Peter Shapiro, managing director at Swap Financial Group, which advises companies and governments on derivatives. "The

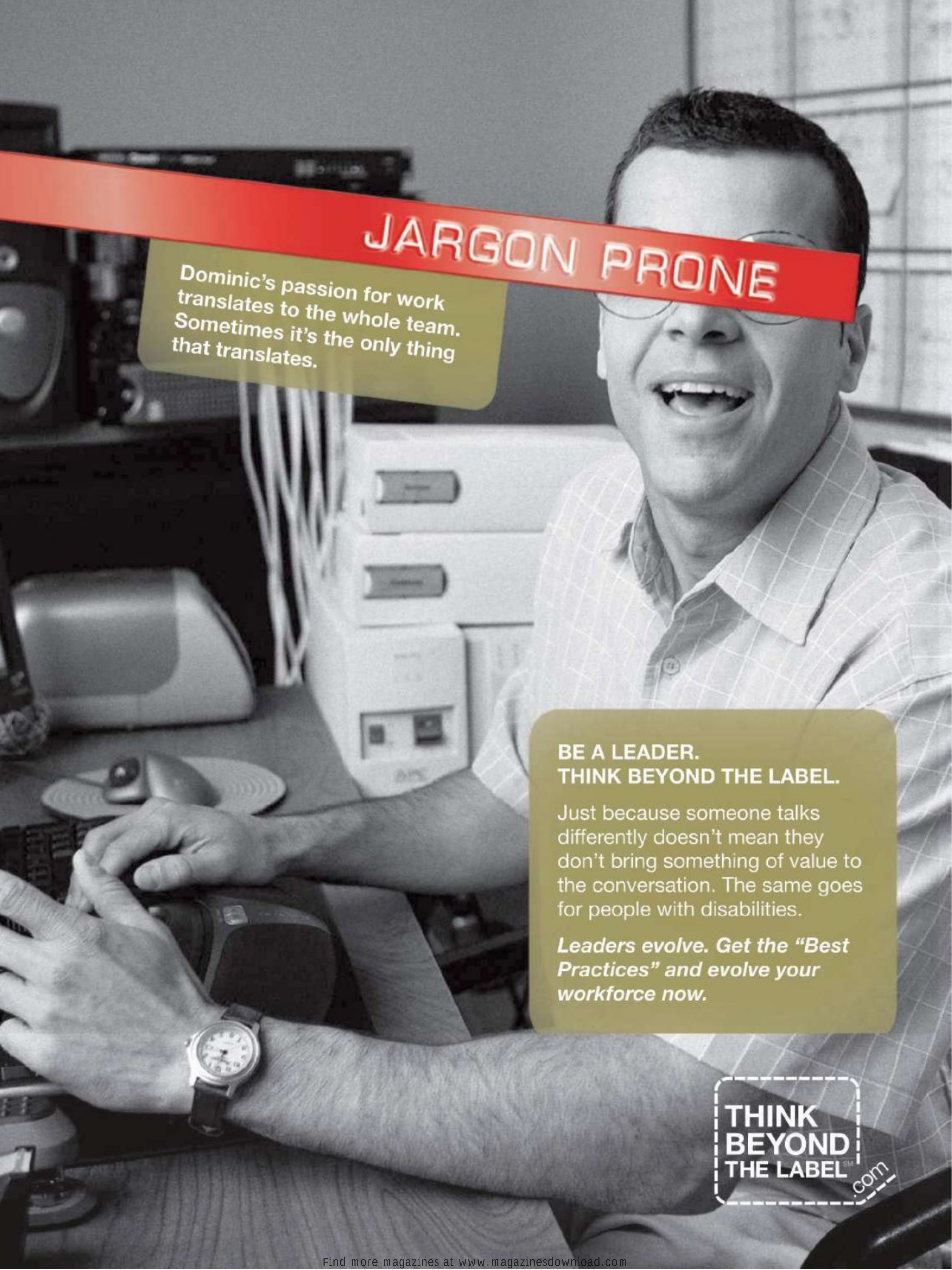
'I don't really see what I could reproach myself for,' says Thiollière, who approved 26 exotic contracts in his years as mayor of Saint-Étienne



Thiollière leaves a press conference after losing his mayoral reelection bid in 2008

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investor is taking a chance in hopes of a high return. It has nothing to do with hedging."

Use of swaps in Europe soared in the late 1990s and early 2000s because banks pitched them as the easiest way to reduce costs on fixed-rate loans, according to Patrice Chatard, general manager of Finance Active, which helps more than 1,000 localities across Western Europe manage their debt. Understanding the products requires complex software and financial expertise that local governments often don't have. The banks that sold the derivatives were many of the same ones that later received government bailouts. "I'm not against all structured products, but if you can't explain the real utility to a mayor in under a minute, you shouldn't buy it," says Sandra de Pinho, finance director for Lille in northern France.

City and regional governments in Europe mainly get their financing from banks, while in the U.S. they tend to raise funds by selling bonds. Local authorities in the European Union's 27 member states had a combined debt of 1.21 trillion euros in 2008, according to the EU. Government officials used up-front cash payments from guaranteed rates at the beginning of swap contracts to lower their short-term costs and live beyond their means. "These municipal swaps are the same thing as Greece," says Emmanuel Fruchard, a former banker who is now a city council member in Saint-Germain-en-Laye, near Paris. "It's all trying to dress up your accounts. This isn't traditional asset management; it's like a hedge fund. And it's done in bad faith. An elected official who takes the benefit from the guaranteed low rates [in the early years of a deal] without understanding what happens after his mandate ends is acting in bad faith." Goldman Sachs arranged a currency swap in 2002 that helped Greece hide the size of its annual deficit and national debt. Last fall the country doubled its deficit estimate for 2009, triggering a crisis that eventually led the EU to offer a 30 billion euro rescue package.

Unlike Greece, towns and cities in France can't count on the EU to bail them out. More than 1,000 municipalities in France had 11 billion euros in "risky" contracts at the end of 2009, according to Finance Active. In Italy, about 467 public borrowers faced losses of 2.5 billion euros on derivatives as of the end of September. In Germany, Deutsche Bank sold contracts based on the difference between long- and short-term rates to about 50 municipal governments and utilities. One town, Pforzheim, on the edge of the Black Forest, is taking a 55 million-euro loss after following the bank's advice and taking out bets on interest rates in 2004 and 2005, says former budget director Susanne Weishaar. The town also has a projected 50 million euro annual shortfall thanks to a

1.18m

Quarterly amount, in euros, Saint-Étienne is now obligated to pay Deutsche Bank under the terms of one of its swaps

The effective interest rate Saint-Étienne faced after its swaps contract with Deutsche Bank blew up

24%

decline in tax revenue and rising social costs.

Deutsche Bank, Weishaar says, presented her with a 10-year chart showing that long-term rates were consistently higher than short-term. During an initial phase of guaranteed rates, the town paid 1.5% to the bank on 60 million euros of debt while receiving 3% to 3.75% from the bank. In 2005 and 2006 the difference between long- and short-term rates collapsed and potential losses soared. Weishaar bought more swaps from JPMorgan Chase in a vain attempt to protect the town budget. Pforzheim now owes JPMorgan the equivalent of 11% of its annual budget. The Baden-Württemberg regional government recently ordered the town to cut its budget by 240 million euros, or about 12% annually, over the next four years.

"It's like Easter eggs," said Weishaar, 45, whose decision to buy the swaps is being investigated by a German prosecutor's office. "You want to buy one and somebody sells you a painted hand grenade instead."

Cedric Gail jumps up from his chair and charges over to a whiteboard. With a few strokes of a black marker, Saint-Étienne's finance director shows why some of these contracts are so noxious—because currency fluctuations will determine how much his town owes Dexia and Deutsche Bank.

"Am I angry? No," he says. When he was hired away from the Lyon metro area authority 18 months ago, Grail looked into Saint-Étienne's cupboard and found a nest of snakes: contracts for more than two dozen derivatives, many already renegotiated several times. "My fundamental response is that a city shouldn't bet on the dollar or yen when it has resources only in euros," he says. "And betting on 10 times the yield curve is never right. Some people said we were crying wolf because we started making noise about this before there was any actual impact on our accounts," he adds. "But that impact is coming now and is really going to hit, some later this year and especially next year and the year after."

Saint-Étienne began its gambling spree in 2001. That year, Alfieri, Thiollière's finance director, signed a 22 million euro loan from Dexia at 4.9% to consolidate civic projects. The rate would rise if the benchmark three-month London interbank offered rate, or Libor, exceeded 7%. Alfieri, who declined to comment for this story, signed six swap contracts on that loan between 2005 and 2008, the last three with Deutsche Bank. They lowered the city's effective costs to 4.35% in 2006, 4.07% in 2007, and 4.3% in 2008 and 2009—for a savings of 126,377 euros in the final year alone.

European accounting rules help keep such deals

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hidden, because most local governments have no obligation to set aside cash against potential losses. Their budgets reflect only current-year cash flows. "It's only transparency that will make elected officials scared to invest in dangerous products," said Jean-Christophe Boyer, deputy mayor of Laval in western France, which has swaps covering about 25% of its total debt of 86 million euros. "Even if we banned them today, the impact is coming now, tomorrow, and 10 years from now," he said.

In April 2010 the risks finally hit Saint-Étienne. A 2008 Deutsche Bank swap based on the strength of the British pound against the Swiss franc obligated Saint-Étienne to pay the bank a quarterly payment of 1.18 million euros, equivalent to an annual 24% on the debt—while the bank would pay the city 241,886 euros. The pound has slumped 21% since the deal was signed.

It would cost Saint-Étienne 20 million euros today to cancel that swap, Grail says, running his fingers through his salt-and-pepper hair. That would still leave the town on the hook for the 19 million euros left on its underlying loan from Dexia. "Our goal isn't to go to war with the banks," he says. "Our goal is to protect Saint-Étienne's citizens from the aberrant decisions made by the prior team."

With its suit against Deutsche Bank now pending, the city hasn't paid what it owes the bank and returned the bank's January net payment of 30,735 euros. It has increased the amount set aside for financial risks to 6.5 million euros, from less than 400,000 euros in 2008.

Two of Saint-Étienne's swaps with Royal Bank of Scotland are especially exotic. Called "snowball swaps," they move in steps, with each payment based on the size of the previous one, thus magnifying the trend. Saint-Étienne would need to pay RBS 3.18 million euros to cancel the first snowball and 4.05 million euros to cancel the second, according to the mayor's office. A spokeswoman for RBS declined to comment.

Saint-Étienne asked Eric Gissler, a Finance Ministry official named last year to mediate disputes over swaps, to help negotiate a settlement with Natixis, according to Jean-Claude Bertrand, the deputy mayor for finance. The town has been unable to alter its contracts with RBS, he said. Christian Le Hir, chief legal officer for Natixis, said his firm is ready to negotiate. "Banks were looking to sell products," Le Hir says. "Local governments were looking to buy them because it suited them, at least in the short term."

To begin clawing its way back, Saint-Étienne trimmed 19%, or 50 million euros, from its 2008-14 investment plan and raised local taxes twice—by 7.5% in 2009 and 2% this year. Local authorities also canceled a 120 million-euro streetcar line and slashed by 75% a plan to renovate the local coal-mining museum. "The real pain for us is just starting now and is coming over the next several years," says Grail. That's because Saint-Étienne's guaranteed rates under eight remaining swaps end between now and September 2012, while one allows the city to pay nothing until 2020. (After that, a complex and potentially costly formula based on currency fluctuations kicks in.) They can't be restructured, Grail says, because "no bank today will take on a swap where you're betting on 10 times the yield curve, or on currencies. So we're stuck, and the explosions are starting to go off."

Efforts to regulate derivatives sales to local governments remain patchy. The EC isn't working on EU-wide rules. In France, the central government negotiated a voluntary good-conduct agreement in which banks pledged not to sell local authorities interest-rate contracts based on debt principal, commodities, or foreign currencies; it wasn't signed by all banks operating there or by all local government associations. In Italy, a Senate committee in March proposed a ban on swaps for smaller towns, except provincial capitals. And a Milan judge has charged Deutsche Bank, JPMorgan, UBS, and Depfa Bank with fraud linked to the sale of derivatives to that city. The trial is scheduled to start on May 6. The firms deny wrongdoing.

Thiollière, the former mayor, is curiously unruffled by the financial cataclysm he invited into his hometown. "If I put myself in the context of 10 years ago, I don't really see what I could reproach myself for," he says, sitting in the gilded conference room of the French Senate, in Paris, where he represents the Loire Department. "I made sure I had a professional team, with a clear goal to lower debt, lower taxes, lower financial charges. There are useful debts, ones that allow you to rebuild a city."

Four years after being voted fifth-best mayor in the world and two years after being voted out of office, Senator Thiollière, now 55, appears placid. "Managing a town is like running a company," he says. "It's taking risks daily." Ⓑ

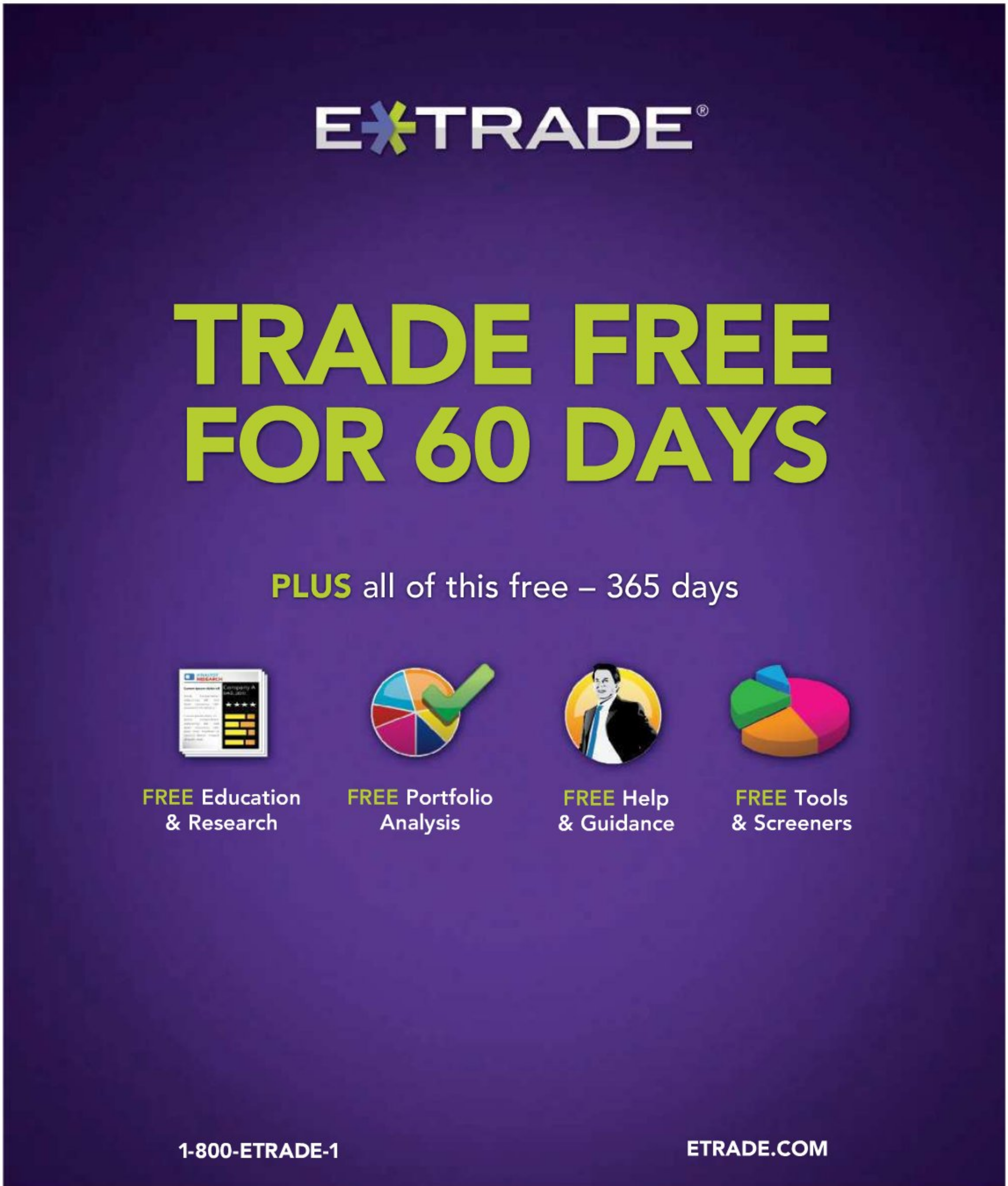
"It's a joke that we're in markets like this," says Grail. "We're playing the dollar against the Swiss franc until 2042"



When Grail became finance director in 2008 he discovered two dozen exotic contracts

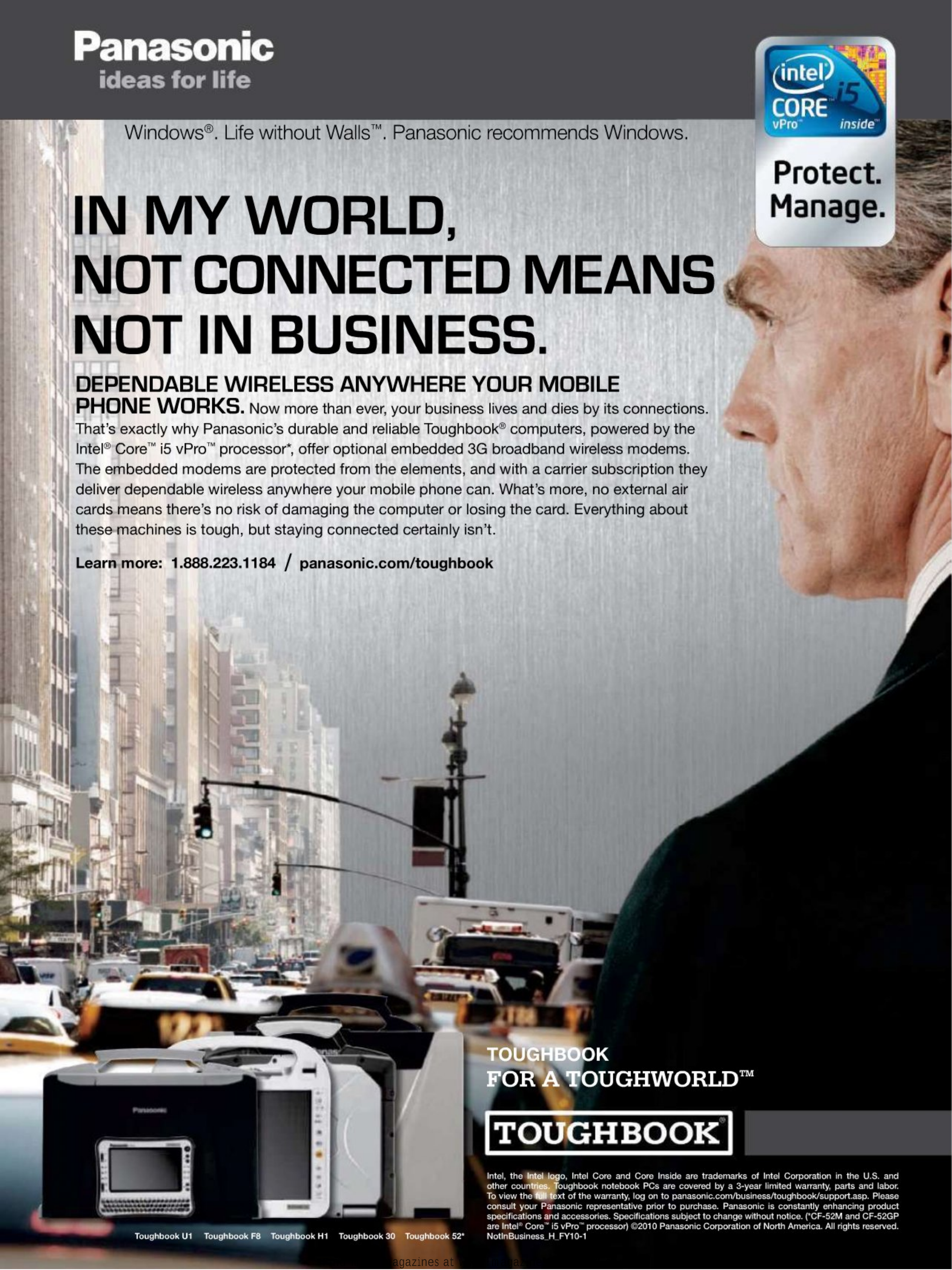
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A massive natural gas discovery in Israel could make billionaire Isaac Tshuva the country's energy savior and refuel his plans to populate the planet with Plaza Hotels

Cooking With Gas

By David Wainer and Calev Ben-David



ISRAEL SUN

Isaac Tshuva arranges sugar packets on a table at his Leonardo City Tower Hotel in Tel Aviv, each one representing the location of a gas deposit off the Israeli coast: The uppermost packet is the Tamar field that his company, Delek Group, helped discover last year. Two packets below it are smaller strikes to the south, which Tshuva says indicate there's more gas still to be tapped. "The amounts we've found are going to fulfill much of Israel's energy demand for the next two decades," says the 61-year-old billionaire, whose family immigrated to Israel from Libya in 1948 when he was an infant. The discoveries have turned Tshuva into Israel's energy king and the country's sixth-richest citizen, with an estimated

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net worth of $2 billion, according to *TheMarker*, a Tel Aviv business daily. The gas finds ultimately could meet half of Israel's energy needs and provide the country with the energy independence that is vital to its security.

Surrounded by oil-rich but hostile neighbors, Israel has long fretted about energy. Moses, the joke goes, led his people around the desert for 40 years before settling in the only place in the Middle East without oil. The Tamar field's estimated 7.7 trillion cubic feet of gas will go a long way toward weaning Israel from dependence on imported coal and gas. "These are all blessings from the heavens," Tshuva says as he settles into a black leather armchair.

The discovery is helping him expand a global empire that includes luxury apartment towers, power plants, gas stations, and New York's Plaza Hotel. It may also help salvage an audacious $5 billion plan to put a Plaza on the Las Vegas Strip that the financial crisis has stalled.

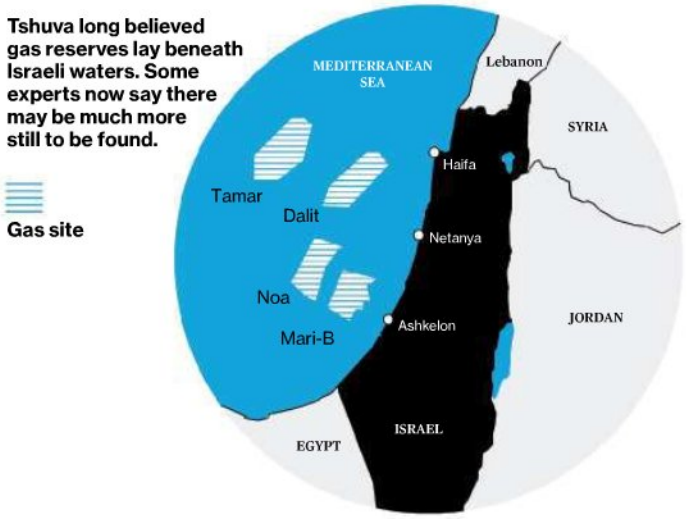
A gregarious man who greets visitors with a warm pat on the shoulder and favors dark suits with no tie, Tshuva has a taste for extravagant projects. And he's constantly on the prowl for ideas, even if they entail big risks—such as his decade-long hunt for gas in Israel's waters that has only now started to pay off. "The man has good intuition," says Ronen Elgali, head of research at Sphera Fund, a Tel Aviv hedge fund with $360 million under management.

Growing up in Netanya, a quiet coastal city some 20 miles north of Tel Aviv, Tshuva shared a one-room apartment with his parents, grandmother, and seven siblings. He started working as a laborer at age 12 to support his family, attending school at night. After three years in the army he skipped college and began working in construction for the Defense Ministry. When Israel captured the Sinai Peninsula in the 1967 war, he helped erect the Bar Lev Line, a chain of fortifications along the Suez Canal. By the early 1970s, Tshuva was winning contracts to build low-income housing in Netanya.

Over the years, Tshuva has picked up powerful friends—and endured his share of criticism. He pals around with Israeli President Shimon Peres and was close to former Prime Minister Ariel Sharon. A close business relationship with Ted Arison, the Israeli American founder of Miami-based Carnival Cruise Lines, paid off in 1998. At the time, Tshuva was a second-tier building contractor looking to elbow his way into Israel's business elite. He had acquired a quarter of the shares of Delek Group, then an automobile importer and Israel's second-biggest gas station chain, and wanted to gain control of the company and its cash hoard of tens of millions of dollars. Arison's Bank Hapoalim held a 25% stake in Delek that he agreed to sell to Tshuva for some $100 million.

'Blessings from Heaven'

Tshuva long believed gas reserves lay beneath Israeli waters. Some experts now say there may be much more still to be found.



Tshuva and his family marking the Plaza's centennial in 2007



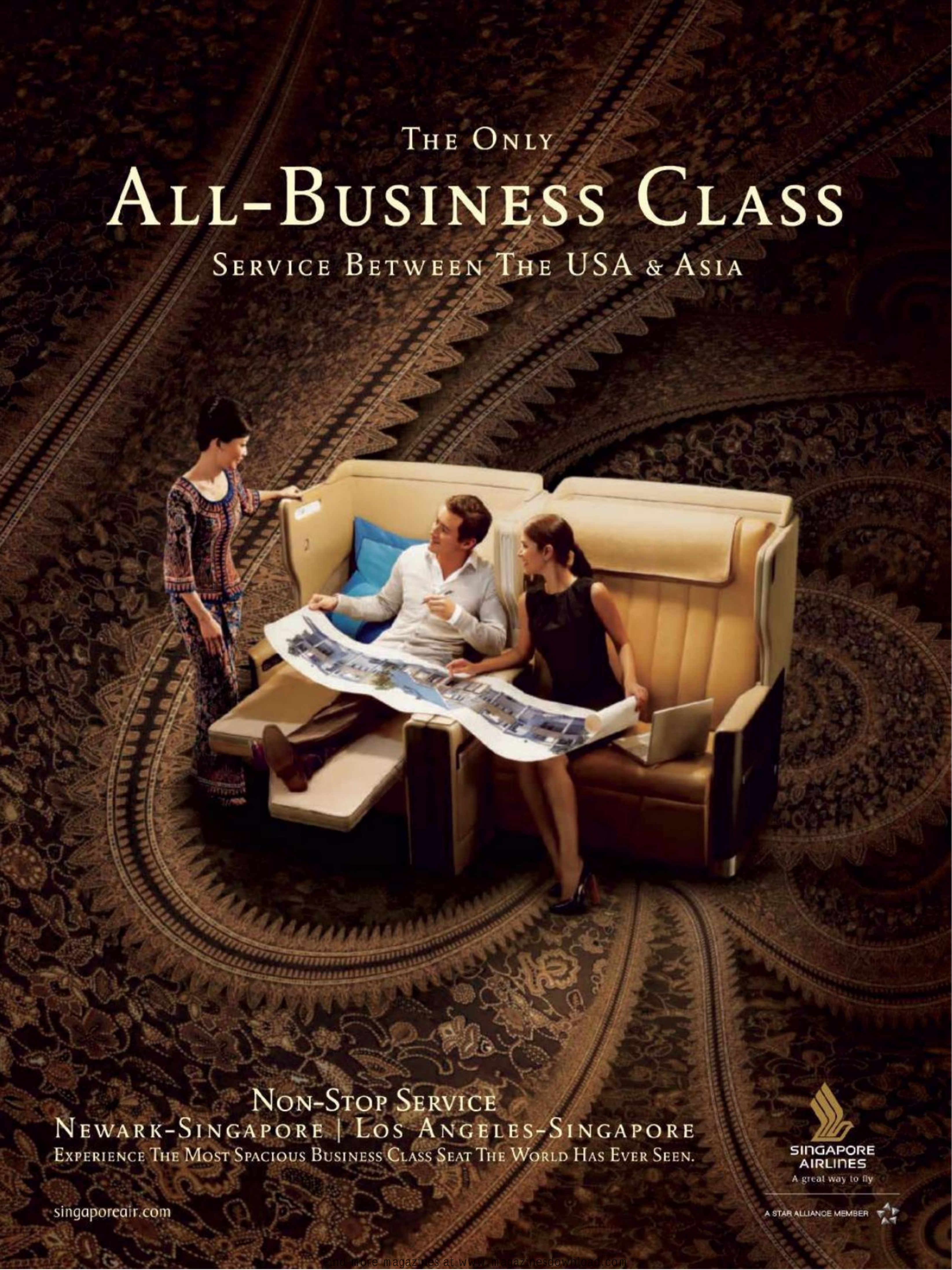
JEMAL COUNTESS/WIREIMAGE

The takeover wasn't universally welcomed in Israel. To win Delek, Tshuva had to push out the Recanati family, an influential Israeli clan that had extensive interests in shipping and banking. Many in the Israeli business community, most of whom are of European origin, saw the uneducated Libyan emigré as an interloper. Buying Delek "was a big jump," says Moshe Tery, former chairman of the Israel Securities Authority, who in the past has worked as a money manager for Tshuva. "Eyebrows were raised due to his unusual background."

By the late 2000s, Tshuva had built Delek into a $10 billion conglomerate with holdings in insurance, oil refineries, auto sales, and other businesses. An important subsidiary, Delek Real Estate, made an ill-timed $738 million gamble in 2007 on British highway service stations. As markets around the world tumbled in 2008, Delek's shares fell by 86% and its bonds sank by about half. For the year, Delek reported a loss of $490 million, including a $430 million shortfall at the real estate subsidiary, which Tshuva spun off last year.

Tshuva's fortunes improved in January 2009, when his bet on gas finally paid off. In 2000, Delek and partners had found the Noa and Mari-B offshore fields; they started pumping from them four years later. Convinced there was more gas in the area, Tshuva kept pushing. Last year, the group fi-

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Tshuva and Danker paid $1.25 billion for Las Vegas' Frontier—and promptly blew it up to make room for an as-yet-unbuilt Plaza

nally drilled into Tamar and a nearby field called Dalit, the largest gas find ever in Israel and the second-biggest in the world over the past two years. "The rainfall came at the right time," says Asaf Bartfeld, Delek Group's CEO.

Within a month of the discovery, Delek's bonds had climbed 50%. Its shares have since risen more than fivefold, giving the company a value of $2.6 billion. Tshuva owns 64% of Delek, which controls just under a third of Tamar. (Houston-based Noble Energy, in which Delek owns a small share, owns 36%; Israeli gas explorer Isramco Negev 2 holds 29%.) The partners are now waiting for survey results from nearby fields that may hold even more gas than Tamar, says Yaron Zer, an analyst at Clal Finance Brokerage. "The chances for another big find are quite high," Zer says. On Apr. 8 the U.S. Geological Survey said the eastern Mediterranean may have 30 times the reserves that have been found at Tamar.

That doesn't mean much, of course, if the gas can't be sold profitably. The International Energy Agency says the global gas market faces an "acute glut" in coming years. Since peaking in 2008, U.S. and British natural gas futures have plunged 60% because of a surge in supplies from sources such as shale deposits and a growing international trade in liquefied natural gas. "The market is hyped up on the gas find, but there are risks associated with this project's development," says Guil Bashan, an analyst at Israel Brokerage & Investments.

Israel's gas market, though, is a special case. The only neighbor willing to sell gas to Israel is Egypt, so there's no oversupply. The Israeli government sees huge strategic importance in Tamar, since until now the country has imported almost all of its energy. Delek and its partners will spend some $3 billion developing the field, 50 miles off the coast in more than 6,000 feet of water, but they already have $11 billion-plus in commitments from Israeli utilities. Production is expected to hit full capacity by 2015.

Despite his growing fortune, Tshuva doesn't flaunt his wealth. He drives a beige 2008 Cadillac sedan and refuses to wear a watch because his parents couldn't afford to buy him one for his bar mitzvah. He lives in a comfortable but not extravagant house where, neighbors say, the father of five often answers the door. He holds no official title at either Delek or his real estate venture, El-Ad Group. Delek's headquarters are a two-minute drive from Tshuva's house in Netanya rather than in tonier Tel Aviv. The company occupies a four-story concrete building wedged between an IKEA store and a brewery in an industrial area far from Netanya's plush beach resorts.

Tshuva's international real estate investments, however, are anything but low-key. El-Ad, a privately held company named for his only son, Elad, has developed dozens of high-end residential projects from Los Angeles to Singapore in the past decade, amassing a portfolio that the firm says is worth $7.5 billion.

In 2004, El-Ad tried to buy the former Mayflower Hotel on Central Park West in New York. After months of negotiations, Tshuva lost to a partnership that included another Israeli business clan, the Ofers (which ultimately razed the hotel and built a luxury apartment tower that's home to celebrities such as Sting and Denzel Washington). "I was very disappointed," says El-Ad CEO Miki Naftali, who was dispatched to New York after developing residential projects for Tshuva in Israel. "We

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**Ranked as of 2/17/10.
† Jim Cramer, *Getting Back to Even* (Simon & Schuster).

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were very keen at the time to find a development opportunity overlooking Central Park."

As it turns out, an even more prestigious property with Central Park views would soon be available. Leaving the meeting where he learned he had lost the Mayflower, Naftali passed the Plaza and thought he might be able to make a play for the storied hotel. He found an intermediary to contact Singapore magnate Kwek Leng Beng, whose Millennium & Copthorne Hotels owned half of the Plaza. After Kwek reluctantly agreed to a 30-minute meeting in Singapore, Tshuva instructed Naftali to keep the price down but to not let the "deal fall through," Naftali recalls. "When he wants something ... he's almost impossible to stop." Naftali's talk with Kwek stretched to an entire day, and the two soon agreed that Kwek would sell. In August 2004, El-Ad said it would buy the hotel for $675 million.

When Tshuva's redevelopment plan for the hotel started to spread, it caused an uproar. His daughter, architect Gal Nauer, planned a $450 million renovation that would see much of the building converted into 152 apartments, leaving just 282 hotel rooms, down from 805. The *New York Post* accused El-Ad of "pimping out the Plaza" and "selling the soul of the institution." Tshuva counters that he helped save a troubled New York landmark and that he had little difficulty selling the new condos—for a total of $1.4 billion. "The Plaza today is one of the most luxurious and sought-after properties in Manhattan and is an attraction for tourists from all over the world," Tshuva says.

Not all the new owners were pleased. Russian oligarch Andrei Vavilov, for instance, bought two penthouse apartments for $53.5 million, then later sued El-Ad saying they did not live up to expectations. The suit was settled out of court. El-Ad is now being sued by renowned Vienna pastry emporium Demel, which backed out of its 10-year lease in the Plaza's retail concourse after just two years. In its suit, Demel accuses the hotel of promising an "unparalleled shopping experience" and instead delivering a mall "populated with unknown or unsuitable retailers." El-Ad is countersuing for unpaid rent.

Résumé Isaac Tshuva

Net Worth — $2 billion

Born — 1948, Tripoli, Libya

Immigrated — 1948, to Israel

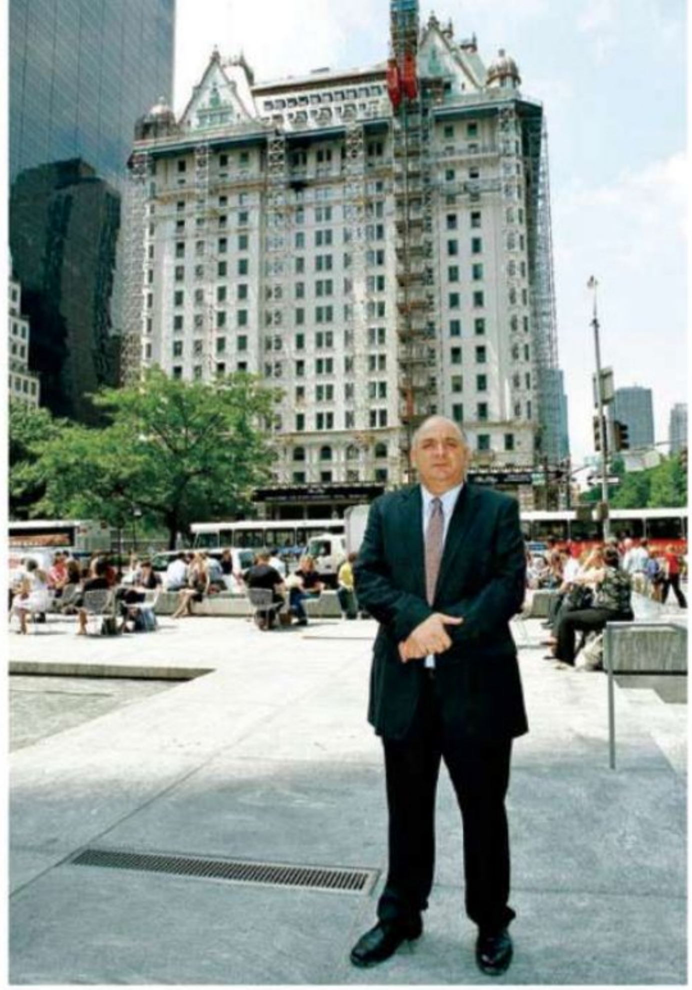
Education — Finished high school by studying nights; never received a university degree

Career — Started working construction at age 12 to support his family; after three years in the army, worked as building contractor for the Defense Ministry

Public Company — Delek Group, partner in Israel's most significant gas find ever and owner of energy assets on four continents

Private Company — El-Ad, owner of New York's Plaza Hotel and developer of high-end residential properties worldwide

Car — 2008 Cadillac that he drives himself



Tshuva's takeover of the Plaza has been troubled

KFIR ZIV

Along with the hotel, Tshuva got the Plaza name, which he planned to turn into a global brand. Tshuva and Israeli tycoon Nochi Danker in 2007 paid $1.25 billion for the Frontier Hotel in Las Vegas, which the pair demolished to make way for a resort that was to carry the Plaza brand name. But when Las Vegas tourism slumped in the midst of the financial crisis, that plan was put on hold. This March the partners wrote down the property by 20%, valuing it at some $1 billion. Today the former Frontier site is just an empty lot filled with rubble.

Even with half-built, mothballed projects littering the Las Vegas landscape and hotel vacancies hitting record levels, Naftali insists El-Ad's Plaza development will resume early next year. "There's a lot of money [for financing such projects] on the sidelines right now and we should be able to take advantage of that," Naftali says. Ultimately, Tshuva envisions an empire of 30 Plazas worldwide, though he acknowledges that "future generations [may] have to carry this forward."

Back in Israel, Tshuva has an equally grandiose plan, developing what Israelis and Jordanians call the "Valley of Peace," a 106-mile canal to bring water from the Red Sea to the Dead Sea to keep the salt lake from drying up. The project, which relies on the heretofore unimaginable cooperation of Israel, Jordan, and the Palestinian Authority, would boost the economy on both sides of the border with hotels, restaurants, parks, and perhaps a dam to generate hydro power. A major role in that development would surely cement Tshuva's reputation as a risk-taking visionary—and could bring ever more cash into his pockets. Tshuva acknowledges that the effort will take years and that he may not live to see its completion. "I have many dreams and plans," he says. "Regretfully, even a hundred years will not suffice to properly realize even a tenth of them." B

—With Oshrat Carmiel and Beth Jinks

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The man who went long on tigers
Page 128



Hitmen for Hire

The best company softball team in the country is all work, no play. *By Paul Wachter*

You lookin' at me? Players for Resmondo, a sod company, make up to $60K a year. Photographs by Danielle Levitt

(TIGER) DLILLC/CORBIS

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Etc. Softball

With two outs in the top of the seventh, slow-pitch softball's final inning, Gregg Connell approaches the plate with his team in an unfamiliar position: They're about to lose. It's a drizzly April day in Florida, and the best teams in the country have assembled at Osceola County Stadium, the Houston Astros' spring training facility, for the first big company tournament of the season. Connell, a 28-year-old bull of a man, drives the ball 400-plus feet for a triple, giving his squad, Resmondo, a 21-20 lead over Art Explosion. When I ask Connell about his clutch hit later, he shrugs his massive shoulders: "That's what I get paid to do."

He's not joking. Ostensibly, softball is an amateur sport. That hasn't stopped Travis Resmondo, a 37-year-old multimillionaire purveyor of sod throughout Florida, from paying each of his players up to $60,000 annually. If Resmondo fields the company softball equivalent of the Yankees, archrival Dan Smith, a 64-year-old California construction magnate, runs the Red Sox (though the team is known simply by his name). Each spends more than $500,000 per year on his team, more than double the closest corporate competitors. In the past decade, Resmondo has won five United States Specialty Sports Assn. World Series. Smith has won four. "It's sort of like Tiger and golf," says Don DeDonatis, who heads the USSSA, softball's largest organization. "If Resmondo and Dan Smith aren't at the tournament, nobody comes."

There's a downside to dominance, though. When Connell—who works full-time as an electrician—hits his clutch triple, the only cheers come from the Resmondo dugout. There are no kegs and virtually no fun. Just paid professionals doing a job.

The origins of softball can be traced to Thanksgiving Day at Chicago's Farragut Boat Club in 1887, where Harvard and Yale alumni had assembled to hear the results of the schools' annual football game. A Yalie tossed a boxing glove at a Harvard grad, who batted it away with a broom handle—a Eureka moment for George Hancock, a reporter on the scene who improvised a set of rules for a new game based on baseball.

By the late 1970s, 40 million Americans were playing softball, and companies spent lavishly on their teams. Steele's Sports, an Ohio sporting-goods manufacturer, fielded that era's equivalent of Resmondo—with one key difference. "We all worked for Steele's," says Mike Macenko, 54, a "Men of Steel" veteran who played first base. "When we weren't playing softball, we were doing deliveries and sales."

About 20 years ago tax laws changed so that companies could no longer write off softball expenditures as expenses. The number of well-funded corporate teams swiftly dropped, leaving the field wide open for a few softball-crazed entrepreneurs willing to spend hundreds of thousands of dollars each year to win the nation's top amateur tournaments, just for their own satisfaction. There are several, often feuding, governing bodies of softball, presiding over more than 100,000 sanctioned teams, not including the casual corporate, church, and social leagues that bloom each spring. The elite level, though, is an entirely separate universe. Players for Dan Smith and Resmondo live across the country and are flown in solely to play ball. Many work in the sporting-goods industry, while others are schoolteachers and construction workers. "Resmondo and Dan Smith are teams of hired guns," says Gene Smith, publisher of *Softball Magazine*.



Resmondo's players are flown in for games

PHOTOGRAPH BY DANIELLE LEVITT FOR BLOOMBERG BUSINESSWEEK

"I thought softball was about having a six-pack in the parking lot," says a veteran catcher

The situation strikes even veteran players as odd. "I thought softball was about having a six-pack in the parking lot," says Jeff Wallace, a catcher who has played for Resmondo for 11 years.

As the top level of the game has been professionalized, the grass roots have withered. Only 12.8 million Americans play softball, according to the National Sporting Goods Assn., a sharp decline that Ron Radigonda, executive director of the Amateur Softball Association of America, USSSA's main competitor, chalks up to demographics. "The baby boomers grew the sport," he says, "and now they're in their 60s." Others blame technology. "With the composite bats, a 150-pound guy can hit a softball 400 feet, easy," Macenko says. "At the same time, they've doubled the compression of the balls, which are as hard as croquet balls, to make them go faster and farther." The result is that pitchers are sitting ducks for lethal line drives. Most pitchers in Osceola wore masks, and some batters target opposing players. "Who wants to deal with that?" Macenko says. "Why wouldn't you just play soccer or go bowling?"

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Resmondo surrenders a home run in the bottom of the seventh. With the composite bats, homers are so common that the USSSA sets a limit of 16 per side for the top division, and sluggers don't even have to round the bases (though some of them could really use the cardio). It's double-elimination, and Resmondo wins its next two games before losing to the team sponsored by sporting-goods manufacturer Combat Sports. Jon Oram, who spent seven years in the Cleveland Indians minor-league system, hits the game-winning homer for Combat. Afterward, he concedes that his team got lucky. "Seven out of 10 times, Resmondo's going to beat us," says Oram.

Travis Resmondo was working and couldn't see his half-million-dollar dream team go down in person. When I call to check on his spirits, he isn't upset. The team is still fiddling with its roster, trying out new players such as Vernand Morency, an ex-minor leaguer who also played in the NFL for the Green Bay Packers.

Dan Smith goes on to take the trophy, just as it did last year (though Resmondo then dominated the rest of the 2009 season). Travis Resmondo told me he once threw an ice cream cone into Dan Smith's dugout to rub in a victory. The owners are fierce enemies.

They're also the last of a vanishing tribe. The ASA recently canceled its top division to eliminate juggernaut teams such as those of Resmondo and Smith, and there is no sign of another businessman willing to match their financial commitment. So someday, maybe not too far off, softball could revert to its old-fashioned form. Resmondo says he'll eventually step away from the sport. But not yet. "It's an ego thing," he says. "I wish we'd never lose." **B**

ILLUSTRATION BY JAMESON SIMPSON

A World Without Ringers

Teams that work for a living



While the upper echelon of amateur softball is dominated by quasi-professional players, there are thousands of lower-rung leagues and tournaments in which just getting enough people to show up is a victory. Here, a sampling of teams that did a little better than that.

When Indianapolis-based **Andretti Autosport** is not helping the likes of Marco Andretti and Danica Patrick win races, the company kills on the softball field, winning the USSSA's Men's Corporate B World Tournament last year. "Working on race cars, we have pretty good chemistry," says chief mechanic/second baseman Keith Badger.

Coed softball has countless leagues of its own, among them the New York Corporate Co-Ed Softball League, which was won last year by the law firm **Frommer, Lawrence & Haug.** They can't defend their title, however. Key players "left for the DC office," explains infielder/associate Philip Kouyoumdjian.

Kentucky Steel Erectors, which constructs warehouse stores for Wal-Mart, Sam's Club, and Home Depot, won the 2009 American Softball Assn.'s Men's Industrial Slow Pitch Championships "We'd finished second for a couple years," says Craig Tincher, a company vice-president who is also a star pitcher, "so we weren't shocked we finally won."

The 2009 winner of Atlanta's Architects & Engineers Softball League was the consulting and engineering firm **Newcomb & Boyd**, recently selected to engineer the sustainably designed dormitories at Emory University. The secret to its success, says IT manager Chris Sullins, is less indomitable talent than "we had a group of guys committed to showing up."

The **Outback Steakhouse** chain holds its own double-elimination tournament for Northeast franchises, awarding the Koala Kup. The 2009 winner was Southington, Conn., which edged Yonkers, N.Y., 9-6 in the finals. It was a miraculous turnaround for Southington, which finished 17th the year before. "We had tryouts and scrimmages," explains managing partner Ryan Lucas.

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Etc. A Free Day In...

Houston, Texas

America's fourth-largest city has more than sprawl and humidity. A guide to the good stuff

Petrochem capital of the Americas, sprawl capital of the universe: Houston can seem like a city you can't escape fast enough. That's because you don't really know it. Start your crash course with a visit to sculptor David Adickes' studio—actually to his studio's parking lot, jammed with 18-foot busts of all 43 U.S. Presidents. The giant heads of state were intended for a $600 million suburban redevelopment project that tanked with the economy; in April, Adickes repossessed the busts he'd already delivered. Reunited, the heady crew embodies Houston itself: oversized, earnest, subject to wild financial swings, and peculiar as all get-out. If the Lone Star spirit carries you away, Texan POTUSes Lyndon Johnson and George W. Bush are available for $50,000 apiece.

From Adickes' studio, drive about 10 minutes to leafy Memorial Park and relax with a two-and-a-half-hour guided kayak glide down Buffalo Bayou, the city's mother waterway. The Houston Skyline tour wends east through the Hogg Bird Sanctuary, meanders past the biggest backyards in the fabled Old South-meets-new-money neighborhood known as River Oaks, and ends at the western edge of downtown. That pair of glassy blueish high rises seemingly jutting straight out of swampland? They're the buildings formerly known as Enron: relics from 2001, a gentler era when a $63 billion bankruptcy seemed too large to fathom. (Chevron now occupies both buildings.)

Finish the day by driving 20 minutes west to possibly the most astounding agglomeration of strip malls on the planet. Houston's biggest Chinatown is six square miles of gleeful pan-Asian capitalism stretched along Bellaire Boulevard. Yes, you should order a bucket of crawfish at Cajun Corner, one of a slew of Asian-Cajun restaurants.

Roughly 15,000 Vietnamese immigrants living in Louisiana and Mississippi fled to Houston after Hurricane Katrina. Today they serve up the kind of oysters and étouffée you'd expect in New Orleans. For dessert, drive down the street to the Gelato Cup, a Chinatalian spot where a scoop of Euro-style almond ice cream can be dressed with lychee syrup and sweet red beans. The whacked-out combos make a strange sense once you try them. —*Lisa Gray*

120



Urban kayaking

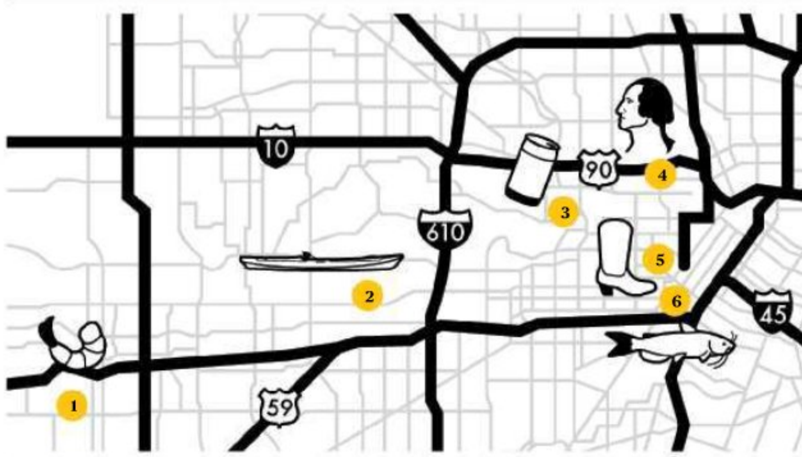


Giant heads of state



Ragin' Cajun cooking

GUIDE: HOUSTON



1. Cajun Corner, 11526 Bellaire Blvd., (281) 530-3474. Crawfish season ends in late May. Just down the street is Gelato Cup, at 9889 Bellaire.

2. Buffalo Bayou Shuttle Service, (713) 538-7433, bayoushuttle.com Summer tour schedule starts May Guided tour includes kayak rental and a ride back to Memorial Park.

3. The Beer Can House, 222 Malone St., (713) 926-6368 for information. In 1968, John Milkovisch began covering his family's bungalow with the debris from his drinking. The results—flattened-beer-can siding, bottle fences that act like stained glass, pull-tab wind chimes—are surprisingly elegant. Open weekends, noon-5.

4. The David Adickes studio, 2500 Summer St., (713) 880-2279. Giant Presidential heads, available for purchase.

5. The Breakfast Klub, 3711 Travis St., (713) 528-8561. "Katfish & Grits" make a fine breakfast, even if the kutesy K's make you kringe. Favorite spot of sharply dressed African-American power brokers.

6. Texas Junk Co., 215 Welch St., (713) 524-6257. The place to buy Houston's coolest Texas souvenirs: old road maps, kitschy cowboy mugs, and a warehouse wall's worth of vintage boots.

PHOTOGRAPHS BY BRENT HUMPHREYS FOR BLOOMBERG BUSINESSWEEK; MAP & ICONS BY JAMESON SIMPSON

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Crunch, swallow, repeat: How about popping a few beans?

Choose Your Jolt



Coffee isn't the only way to deliver a caffeine rush

Bored with drip coffee? Has that triple shot of espresso ceased to deliver a reliable jolt? You may want to check out the robust world of alternative caffeine delivery systems, from eating whole beans to literally inhaling the stuff.

From Kaktovik, Alaska, comes Spazzstick, a caffeinated lip balm dreamed up by Richie Holschen, a local police officer who thought he'd tackle two of the long-shift polar cop's greatest foes—chapped lips and exhaustion—with one tube. Holschen once stirred a spoon of pure powdered caffeine into his morning cup of coffee "without realizing how much it was. It was the equivalent of ten pots. I was rather awake the rest of the day." One application of his lip balm equals a sip of coffee.

Last month saw the debut of Le Whif, the brainchild of David Edwards, a professor of biomedical engineering at Harvard. You put a thumb-sized cylinder in your mouth, draw a breath, and enjoy a burst of aerosol-ized espresso—the caffeine equivalent of a sip. It takes just ten puffs to empty the cylinder, so you're more likely to use it as a caffeine supplement—"part of the coffee life," as Edwards puts it—than turn it into your new morning ritual. Still, since it dissolves on your tongue and is absorbed directly in the mouth, Le Whif's caffeine reaches your bloodstream faster than liquid coffee. Spazzstick, according to James Coughlin, a food toxicologist, is similarly effective, because lips have a particularly delicate skin barrier.

And what of mainlining pure, unadulterated coffee? On a recent morning at a café in Brooklyn, Daniel Humphries, a 32-year-old coffee consultant, conducted a blind taste test—of whole roasted beans. There was the Illy Dark Roast ("almost like dirt"), the Starbucks Ethiopian blend (no "popping acidity"), and the pre-ground Dunkin' Donuts Dark Roast ("ashy ... faded"). The winner was a Peruvian single origin from "third wave" roaster Counter Culture. "Smells fantastic," Humphries said, with notes of "lemon" and "toast with honey" and a "juicy flavor."

In America, bean eating is limited to a few eccentrics who show up in Internet forums with an occasional confession ("I love eating coffee beans, especially when I'm pissed off"). The grit is unpleasant; more important, perhaps, a whole bean delivers its energy payload slowly, Coughlin says, like an extended-release pill. "It's gonna take a while for the acidic conditions of the stomach to degrade the shards and extract out the caffeine." B —*Benjamin Wallace*

GETTING YOUR FIX



Plain beans

If you can find one you like, and get past the gritty feel on your tongue, a bean can stand in as a low-dose, extended-release caffeine pill.



Inhaler

Each Le Whif contains 300 mg of coffee powder, sugar, and caffeine, among other ingredients, and costs $3.99. It's available through www.laboshop.fr.



Soap

A company called ThinkGeek offers Shower Shock, a peppermint-scented soap to help you get your morning buzz before even stepping out of the shower. $6.99 per bar at www.thinkgeek.com.



Lip balm

Protect your lips while perking up. Spazzstick is available in mint and vanilla toffee flavors, for $2.99 per tube, at www.thinkgeek.com.

(TOP, LEFT) PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

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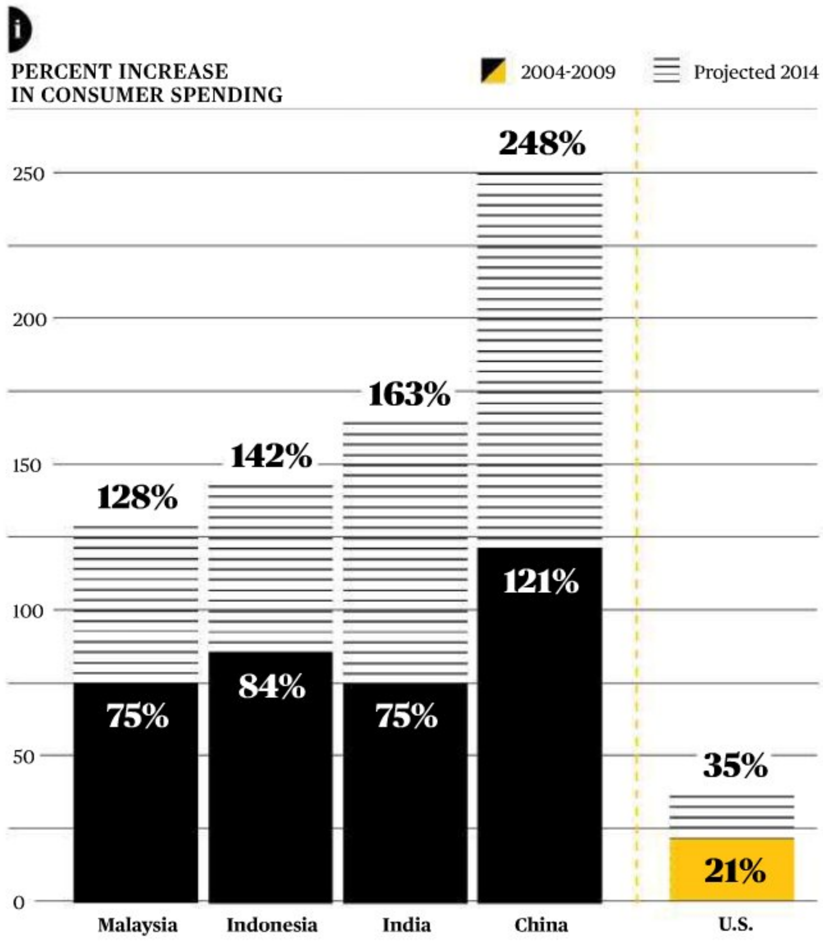
David Winters of Wintergreen Fund on how to tap into the Far East's emerging consumer class

A dramatic global change was accelerated by the economic crisis. A couple of billion people in the Far East, India, and parts of Latin America have joined the economic party. They see everything we have and are willing to work hard to get it, too. They want to look good, eat better, be entertained: basic human desires. So we like consumer names, and oil. You've got an incremental couple of billion people who want cars and motorcycles. To play on higher oil prices, we try to find oil resources in countries that have good legal systems and also good management. The management of **Canadian Natural Resources** owns about 4% of the company. CNQ is worth a lot more than 76, which is what it trades for now.

We also own shares in a company called **Genting,** listed in Malaysia, a gaming company capitalizing on the demand for entertainment–they have Universal Studios on their property in Singapore. On the other hand, we trimmed our position in [U.S. gaming company] **Wynn Resorts;** it has some attractive overseas assets, but the U.S. consumer went into deep freeze. Another holding is **Swatch,** the watchmaker, which is doing well in the Far East. Tiffany, which was having challenges with its watch line, is outsourcing high-end watches from Swatch.

We look for repeat human behavior. People are going to eat chocolate bars 100 years from now. We owned and bought more of **Nestlé** during this period. It is earning an increasing amount in the Far East. One thing we've thought a lot about during this global crisis is pricing power and currency diversification. One of the beauties of Nestlé is that it can generate streams of increasing free cash flow. This helps to protect you as an investor.

Wintergreen's direct exposure to the U.S. is at the lowest it has been in my 25-year career, 70% outside the U.S. today. The U.S. and European multinational companies we invest in are ones with major global exposure. Coke is listed in the U.S., but roughly 80% of its earnings are abroad. Our largest investment is **Jardine Matheson,** a 178-year-old conglomerate with activities in China and Southeast Asia. Jardine dominates Indonesian auto manufacturing and will capitalize on increasing car ownership there. The stock trades at a discount of about 35% to net asset value.



DATA: EUROMONITOR INTERNATIONAL

Dairy Farm's margins are the same as Wal-Mart's, but it is relatively unknown, says Winters

Jardine has a controlling interest in **Dairy Farm,** a supermarket chain that owns other retailers and has 5,000 stores in Southeast Asia, with modest operations in China and India. Dairy Farm's margins are equal to Wal-Mart's, but it is a company that almost no one has heard of. Jardine really is a Western company. You get transparency, and the family and management own about 16% of the company, so their bacon is frying along with the other shareholders'. *—As told to Laura Lallos*

The Stats: Wintergreen Fund/WGRNX: $1.1 billion in assets; annualized return since 2005 inception is 6.1%, placing it in the top 20% of its world stock-fund peers, through Apr. 12. Mutual Global Discovery fund/TEDIX: Annualized return of 9.1% landed it in the top 10% of peers during Winters' 2000-2005 tenure, according to Morningstar.

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Etc. Hands On

3D is Comin' At Ya!



No, these TVs won't be cheap. Yes, you'll need the glasses. What to look for as the first sets hit stores

Ready or not, 3D TV is here. Sets from Samsung and Panasonic are already arriving in U.S. stores, and Sony, LG, Vizio, and others will join the fray in coming months. Despite 3D's success in movie theaters, it will be a while before we know whether it turns out to be must-have home technology or just a fad.

On behalf of those with more curiosity than common sense—and we know who we are—I went to B&H, the landmark New York electronics store, to figure out the right questions to ask when you hit the stores yourself. My 3D sherpa was Kevin Landry, a B&H salesman who's so into this stuff he scored an early Samsung from Korea months ago, which he's been using to view content off the Internet. Here are some of the questions he's bracing for:

Do I have to wear the glasses? Yes, whenever you watch 3D content. And you can only use glasses made for your particular TV brand. The sets work by sending signals that control shutters in the glasses, and there's no standard yet for how that happens.

How big a screen do I want? Even more than with plain old high-definition TV, you don't want to sit too close. A rule of thumb is one-third the distance from which you'll view the set—say, a 50-inch screen if you'll be sitting 12 feet away. You also don't want to sit too far to the side because the signal between the set and the glasses may drop.

LCD or plasma? In Kevin's opinion, plasma, which has been losing ground to lighter, less expensive LCDs, yields a better 3D experience. With LCDs, including LED sets, he says you should pay attention to the refresh rate, the speed at which an image is redrawn. Look for at least 240 hertz.

What will I watch? Make sure you like the picture for 2D content, because for the near future there won't be much else. ESPN is launching a 3D sports service in June, and satellite and cable providers have plans to add content. Still, the pickings will initially be sparse. You'll want one of the new generation of 3D Blu-ray players; unlike the glasses, you won't have to buy the same brand of player as your TV.

How much will it cost? Lots. B&H is selling a 55-inch Samsung set with two pairs of glasses for $2,969. Add $250 to $400 for the Blu-ray; extra glasses will run $150 to $200 a pair.

Will it make me sick? Possibly. Samsung warned of potential side effects including seizures or strokes, and pregnant women, children, and teenagers should be especially careful. Some users may also experience headaches or nausea, though that may just be an adverse reaction to 3D's cost and complexity.

The smartest thing to do right now is wait and see how 3D plays out. The second smartest is to make sure that your electronics store has a good return policy. B —*Rich Jaroslovsky*

3D GUIDE

Five things to watch:

1. **ESPN 3D**, launching in June with coverage of FIFA World Cup.

2. **N3D**, a new DirecTV channel in partnership with Panasonic featuring content from other sources, including CBS, Fox Sports, and HDNet.

3. **Discovery Communications'** planned 3D channel, being developed in partnership with Sony and Imax.

4. ***Monsters vs. Aliens*** Blu-ray 3D, free with Samsung TV.

5. Trailers and short films from **Yabazam.com**, if you connect your set to the Internet.

ILLUSTRATION BY NATHAN FOX

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From Clawing at Equities to Rescuing Rare Tigers

Nikhil Nagle chucked a hot job at Citigroup for the hot jungles of India

Growing up in a small apartment in Mumbai, Nikhil Nagle learned about wildlife the same way as a typical American kid–from the Discovery Channel. After finishing his electrical engineering degree and MBA, and getting a fast-track job at ICICI Bank, he took his first vacation to a national park in India in 1996. He saw a tiger's pug marks–big cat paw prints–but no tiger. Then, in 1997, from the back of an elephant in the same park, Nagle saw one for the first time. "I fell in love," he says. Over the next 14 years, Nagle spent almost every vacation in national parks in India or Sri Lanka. "Tigers are quite secretive," he says. "You listen to the alarm calls of deer, monkeys, and peacocks to track them."

In 1900 there were about 40,000 wild tigers in India; today, the official count is 1,400. Nagle says that is "highly optimistic" and guesses there are 800. About 60 were poached in India last year, he says. As Nagle watched the tiger population dwindle, his passion for wildlife became a mission. He gave "a fairly large amount" to Kanha National Park, where he had seen the tiger, and started thinking about what more he could do. Earlier this year, after eight years at Citigroup, where he oversaw trading in Indian equities (and from 2002 to 2005, trading in some Southeast Asian markets), Nagle resigned and launched Last Wilderness Foundation, devoted to conservation.

Nagle has a Web site, an office, and six employees researching national parks. For now, he's mostly meeting conservation experts. "I know the big problems–poaching and human pressures on animal habitats," he says. "But to solve them you need to spend a lot of time on the ground to understand the intricacies."

The decision to leave Citi wasn't easy. "I was very, very attached to the people," he says. "It was just that I had another passion in life. You can't wait to be 55 to try something new." He'll keep his 2,000-square-foot apartment in Mumbai, and he'll still drive a Porsche Cayenne SUV, albeit not a red one (he has a history of crashing those). Beyond that, he isn't planning to live the high life. "I will never earn any money doing this," he says. "I'll trade my own account and use that to pay overhead and salaries. I was good at what I did, so hopefully I will be good at this, too." —*Joan Caplin*



Nagle in Ranthambore National Park, where temperatures can hit 117F



The Royal Bengal tiger, which can be found in Kanha National Park

THE ECONOMICS OF TIGER POACHING

Wild tigers, worldwide, 1900: 100,000; **2010:** 3,000 (est.)	
Wild tigers, India, 2010: 1,400 (est.)	
Wild tigers poached in India, 2006-09: 700 (est.)	
Price paid to poachers for a complete tiger: $5,000	
Price paid for a complete tiger at market: $50,000	
Price paid for a tiger skin at market: $25,000-$35,000	
Price per tiger "part" (bone fragments, whiskers, penis): $320-$2,000	
Earnings per day were poacher to work as a farmer: $1	

COST TO GO FROM TRADING TO TIGERS

Annual overhead for office, staff of six: $125,000-$150,000	
Citigroup wardrobe, average cost of suit: $3,000	
Today's wardrobe, Safari trousers and cotton T-shirt: $70	

DATA: WILDLIFE CONSERVATION SOCIETY, TRAFFIC

(TOP) PHOTOGRAPH BY MICHAEL RUBENSTEIN FOR BLOOMBERG BUSINESSWEEK; (BOTTOM) PHOTO COURTESY NIKHIL NAGLE

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While our nation may have new healthcare laws, much work remains. We need to build a better healthcare system where people live healthier lives. We must make fundamental changes to how care is delivered so that people don't just have access to care, but that everyone receives the highest quality care. And we must address the rising cost of healthcare and bring spending in line with costs in other areas of our economy.

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The Office Sneaker

Finding a shoe that puts your best foot forward

The Want: It's acceptable to wear sneakers at many offices, but there are a million options–and most should be avoided. Racing stripes, garish colors, logos, and conspicuous rubber soles send the wrong message: namely, I am not serious. You need a model that works with your office culture, as well as wool suit pants and jeans. It ought to be minimal, a tad formal, eminently tasteful. Dark colors hide stains and dirt.

The Get: The Stan Smith, in matte-finish black ($60 at www.Adidas.com). Made of stiff Argentine leather that always looks smooth and uncreased, it reads as more real shoe than gym shoe, without being overly sleek and fey. Classic. Ⓑ —*Stephen Treffinger*

WHAT TO AVOID

1.



Cuffs

Cuffed pants with sneakers can look messy and young (in a bad way). Stick with straight legs and dark fabrics.

2.



Bare Ankles

Always wear socks. Plain black or gray, without sporty emblems, are the best for this sneaker.

3.



Dirt

Zero tolerance. The moment sneakers look the slightest bit scuffed-up, they don't come to the office anymore.



Introduced in 1965, the shoe was originally named for the French tennis player Robert Haillet–until 1971, when Stan Smith won the U.S. Open

Adidas has sold 30 million since 1971, including a Kermit the Frog version (not recommended for the office)

PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATIONS BY JAMESON SIMPSON

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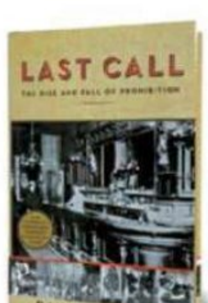
Revelers toasting the end of Prohibition in New York City, 1933



When the Country Went Cold Turkey

A vivid retelling of Prohibition revels in the unintended consequences of government intervention. *By Tyler Cowen*

Last Call: The Rise and Fall of Prohibition
by Daniel Okrent, SCRIBNER, 480 pp., $35.00



Daniel Okrent has splendid timing. At a moment when the role of government regulation is a subject of public fury, Okrent—the first Public Editor of *The New York Times* as well as an inventor of Rotisserie League Baseball—serves up *Last Call: The Rise and Fall of Prohibition*. It's the most persuasive, witty, and best-documented explanation yet as to why Americans decided to endure a ban on alcohol, the federal government's most intrusive regulation of all time.

Okrent can't claim to have discovered Prohibition; Michael Lerner's recent *Dry Manhattan* is another good entry in a well-tilled field. What elevates *Last Call* is, among other things, a clear explanation of the unique confluence of events that caused it. The introduction of the income tax made Prohibition fiscally feasible. Women's suffrage made it politically feasible. World War I created a surfeit of patriotism, a willingness to sacrifice, and an embrace of the expansion of federal power. By 1920 everything was in place for a bold new government intrusion into everyday life.

It's a common view that Prohibition "didn't work," and we've all seen cinematic tales of speakeasies and mob killings that lend credence to the idea that lawlessness ruled. Context is always the first casualty of history, but *Last Call* does a lot to help situate the impulses of the era, and yes, make them seem a little less crazy. At the same time as temperance was flowering, so were crusades for clean water and sanitation, which saved millions of lives. Alcohol, seen as a major scourge of civil society, looked ripe for a once-and-for-all ban that would put mankind on a new course. "Figuring per capita," Okrent writes, "multiply the amount Americans drink today by three and you'll have an idea what much of the nineteenth century was like."

Prohibition did work largely as intended. Alcohol consumption quickly fell to 30% of its previous level; by the time of repeal it was still no more than 70% of its pre-Prohibition level. Most notably, alcohol consumption remained low for decades; the U.S. didn't return to pre-Prohibition levels of per capita consumption until 1973. Alcohol-related diseases fell. It remains the case that high alcohol taxes reduce the incidence of cirrhosis, as reported in the 2007 book *Paying the Tab*, by Philip J. Cook of Duke University.

We still have prohibition for 87 million Americans under the age of 21, and these re-

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Etc. The Stack

strictions work to some degree. Plenty of studies have demonstrated that lowering the drinking age raises the number of alcohol-related motor vehicle accidents, not to mention assaults and other crimes. For all of the fake IDs and 22-year-old beer-distributing friends, the penalties do matter.

They mattered during Prohibition too, but policy is a lot less interesting than creative entrepreneurship. Naturally, the most entertaining chapter of *Last Call* concerns the cottage industries that sprang up around the ban. Dentists and physicians were licensed to grant prescription-based exceptions for "medicinal uses" of alcohol, and a typical doctor had the right to issue 100 prescriptions a month, usually for one pint every 10 days. The prescription itself went for about $3 (plus the costs of purchase), or roughly $32 in 2010 dollars. You can take that price as a rough measure of how the ban made liquor harder to get.

Okrent excels at anecdotes and discussions of hitherto neglected points. I was especially taken by his dive into how words for drinking proliferated ("scofflaw" comes from this era), the wine taster who was facing unemployment and started swallowing his samples, the transformation of Canada into a nexus of smuggling, the widespread theft of grapes, and how ships were supposed to put stoppers in their bottles as they approached the 12-mile coastline limit. Okrent paints a particularly memorable portrait of Irving Fisher, a dry reformer and one of the first celebrity economists, who was also an early influence on Milton Friedman. Fisher considered alcohol as evil as war or unstable money and argued that even moderate consumption harmed economic output. No prominent economist today even toys with Fisher's stance. Now the dominant academic talk is about decriminalizing drugs.

The lesson to be found amid the scofflaws and scoundrels and anecdotes is that, even if they were ultimately on the wrong side of history, temperance forces were far more sensible than we have come to believe. Today so many drugs and addictive substances are illegal or require medical supervision, yet alcohol is consumed relatively freely. Why the difference? Commentators are passionately for or against drug legalization, but after reading and pondering *Last Call* I came away with a new understanding. Every society has some legal and socially acceptable intoxicants. Cocaine prohibition continues where alcohol prohibition ended, in part because cocaine users are easily caricatured and demonized as either spoiled yuppies or violent gang members. It's also easier to get a little bit drunk than a little bit high on crack. So alcohol, despite its well-documented destructiveness, survives as the focal, available, and acceptable intoxicant.

If you want to legalize or decriminalize other drugs, you need to think through more than the liberty-based arguments for individual choice and the economic arguments against black markets. You also need to consider whether drug dealers and users will ever achieve enough social respectability to support a change in regime. Okrent's book doesn't deal much in theory, but it does show how enduring consumption norms are. In doing so he serves up what is likely to be one of this year's best books on American history. B

Temperance forces were far more sensible than we have come to believe

Tyler Cowen is professor of economics at George Mason University and co-proprietor of the blog Marginal Revolution.

The Best Black Market Exposés

Recent dives into the economic netherworld



Hookers

The Wisdom Of Whores: Bureaucrats, Brothels And The Business Of Aids
by Elizabeth Pisani
Pisani, an epidemiologist and journalist, cracks the relationship between the sex trade and international disease prevention with hundreds of interviews with prostitutes, pimps, junkies, and cops across the globe. Her conclusions are controversial and unflinching.





Meth

Methland: The Death And Life Of An American Small Town
by Nick Reding
This deeply disturbing, in-depth profile of the small town of Oelwein, Iowa, (pop. 6,772) gives vivid life to the social and psychological devastation wrought by methamphetamine, the most pernicious of drugs.





Clams

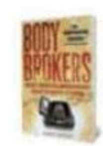
Shell Games: Rogues, Smugglers, And The Hunt For Nature's Bounty
by Craig Welch
A true-life detective story with outlaw scuba divers, nefarious poachers, hit men, and snitches, centered on the pursuit of gargantuan geoduck clams, a delicacy in Asia that can fetch millions on the black market.





Body Parts

Body Brokers: Inside America's Underground Trade in Human Remains
by Annie Cheney
Would you ever guess that fingernails and toenails harvested from cadavers could be worth 18 grand? Annie Cheney offers up this astonishing fact and many more in her gripping account of the global trade in corpses.



(LEFT COLUMN FROM TOP) ALAMY; MIKAEL KARLSSON/ALAMY; AP; GETTY IMAGES

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Etc. Hard Choices

Anne Mulcahy

“It’s really hard to give up power. You get up with a bounce in your step every day because you know you can make a difference”

The former Xerox CEO, retiring as chairman May 20, on her most difficult leadership decision–knowing when to walk away



The CEO job wasn’t something I sought out. It was like being drafted into a war. But I grew up at Xerox, and I wanted it to have a future. I wanted people to be proud of this company again. There was no question I would take the job. The question was whether I could succeed.

I loved every minute of being CEO. The biggest surprise is how hard it is to give it up. I would have thought I’d be running out the door once the place was in shape. I almost understand why so many successions go badly. It’s really hard to give up power. You get up with a bounce in your step every day because you know you can make a difference.

I went from being “I just want to be a CEO” to understanding that I have to be an advocate for women. There’s a responsibility that comes with the position. If you don’t speak about the need to focus on the progress of women, who will? Maybe we’ve reached a degree of parity at the entry level, but we clearly don’t have that in the executive ranks–or in government, for that matter.

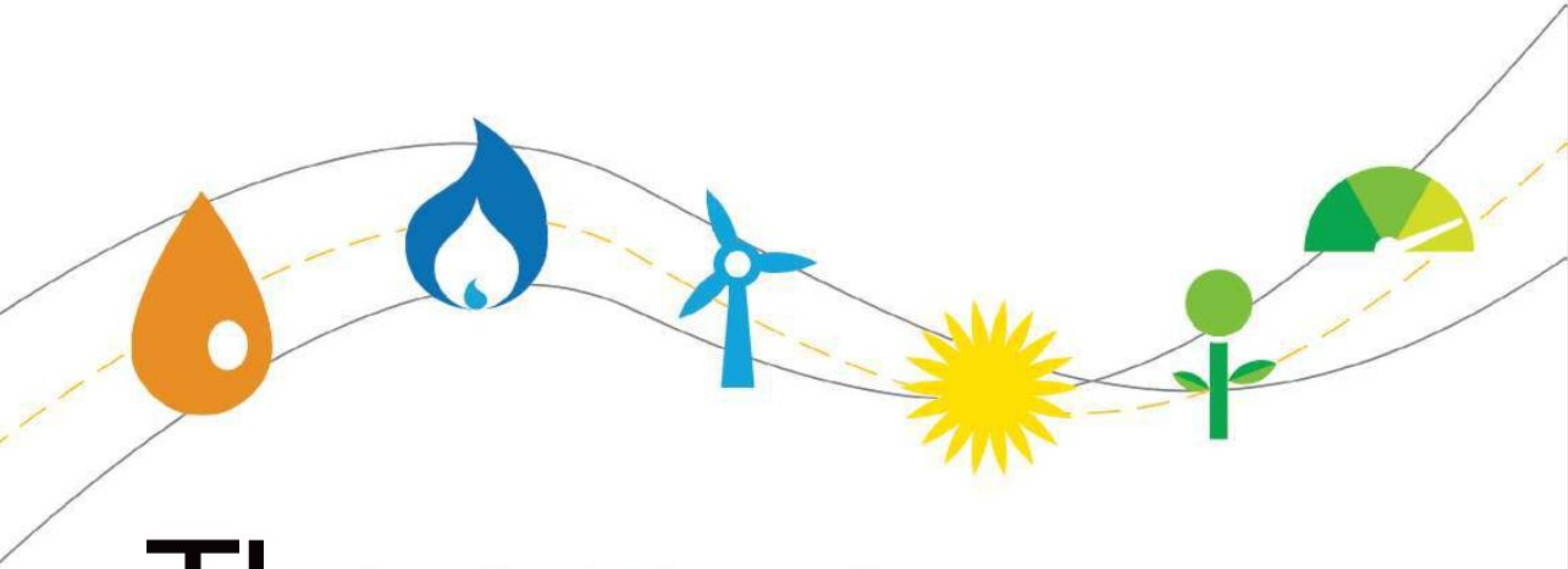
To retire at the age of 57 is a gift. I became head of Xerox at 47… but the more relevant gauge is time in the job. I was there 10 years. That’s long enough. To have stuck around until I was 65 would be a disservice to Xerox, a disservice to my successor [Ursula Burns]. It’s inappropriate to suggest a single individual is the driving force of a company. You need a good dose of ambition, but it has to be tempered by humility. If you wait for the perfect set of circumstances to leave, you will stay too long.

I don’t know yet what the word retirement means. I’ve always said I wouldn’t be head of another public company, and I’ll stick to that. I’m a one-trick pony. I’ve got other things I want to do. I’m chair of the board of Save the Children. I’m not looking to make any more money.

Hobbies? I have none. I used to make them up when people would put together those lists, just so I could sound more interesting. My life has been invested in this job. It’s bittersweet, but I feel really fortunate. B —*As told to Diane Brady*

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